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## **Part III**

## **Department of Housing and Urban Development**

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### **24 CFR Part 81**

**HUD's Housing Goals for the Federal  
National Mortgage Association (Fannie  
Mae) and the Federal Home Loan  
Mortgage Corporation (Freddie Mac) for  
the Years 2005–2008 and Amendments to  
HUD's Regulation of Fannie Mae and  
Freddie Mac; Final Rule**

# DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## 24 CFR Part 81

[Docket No. FR-4790-F-03]

RIN 2501-AC92

### HUD's Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) for the Years 2005-2008 and Amendments to HUD's Regulation of Fannie Mae and Freddie Mac

**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Final rule.

**SUMMARY:** Through this final rule, the Department of Housing and Urban Development establishes new housing goal levels for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the government sponsored enterprises, or GSEs) for calendar years 2005 through 2008. The new housing goal levels are established in accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) and govern the purchase by Fannie Mae and Freddie Mac of mortgages financing low- and moderate-income housing, special affordable housing, and housing in central cities, rural areas and other underserved areas. This rule also establishes new subgoals for the GSEs' acquisitions of home purchase loans that qualify for each of the housing goals. The final rule also establishes a new regulatory section relating to GSE data integrity, amends and adds certain definitions, provides a method for imputing the distribution of GSE-purchased mortgages that lack income data, prohibits goals credit for purchases of loans in transactions with an option to dissolve the purchase in less than one year, and makes a technical change to the counting rules to clarify HUD's rules on double counting of loans.

**EFFECTIVE DATE:** January 1, 2005.

#### FOR FURTHER INFORMATION CONTACT:

Sandra Fostek, Director, Office of Government Sponsored Enterprises, Office of Housing, Room 3150, telephone 202-708-2224. For questions on data or methodology, contact John L. Gardner, Director, Financial Institutions Regulation Division, Office of Policy Development and Research, Room 8212, telephone (202) 708-1464. For legal questions, contact Paul S. Ceja, Deputy Assistant General Counsel for

Government Sponsored Enterprises/RESPA, Office of the General Counsel, Room 9262, telephone 202-708-3137. The address for all of these persons is Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC, 20410. Persons with hearing and speech impairments may access the phone numbers via TTY by calling the Federal Information Relay Service at (800) 877-8399.

#### SUPPLEMENTARY INFORMATION:

##### I. General

###### A. Authority

HUD's authority to regulate the GSEs is established under:

- (1) The Federal National Mortgage Association Charter Act ("Fannie Mae Charter Act"), which is Title III of the National Housing Act, section 301 *et seq.* (12 U.S.C. 1716 *et seq.*);
- (2) The Federal Home Loan Mortgage Corporation Act ("Freddie Mac Act"), which is Title III of the Emergency Home Finance Act of 1970, section 301 *et seq.* (12 U.S.C. 1451 *et seq.*);
- (3) FHEFSSA, enacted as Title XIII of the Housing and Community Development Act of 1992 (Pub. L. 102-550, approved October 28, 1992) (12 U.S.C. 4501-4641); and
- (4) Section 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).

###### B. Background: Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac were chartered by the Congress as GSEs. Pursuant to section 301 of the Fannie Mae Charter Act (12 U.S.C. 1716) and section 301(b) of the Freddie Mac Act (12 U.S.C. 1451), the GSEs were chartered expressly to:

- (1) Provide stability in the secondary market for residential mortgages;
- (2) Respond appropriately to the private capital market;
- (3) Provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and
- (4) Promote access to mortgage credit throughout the nation (including central cities, rural areas, and other underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

Fannie Mae and Freddie Mac engage in two principal businesses: (1) Purchasing and otherwise investing in residential mortgages, and (2) guaranteeing securities backed by residential mortgages. As a result of their status as GSEs, Fannie Mae and Freddie Mac receive significant explicit benefits that are not enjoyed by fully private shareholder-owned corporations in the mortgage market. These benefits include:

- Conditional access to a \$2.25 billion line of credit from the U.S. Treasury (*see* section 306(c)(2) of the Freddie Mac Act and section 304(c) of the Fannie Mae Charter Act);
- Exemption from the securities registration requirements of the U.S. Securities and Exchange Commission and the State securities regulatory agencies (*see* section 306(g) of the Freddie Mac Act and section 304(d) of the Fannie Mae Charter Act);<sup>1</sup> and
- Exemption from all State and local taxes except property taxes (*see* section 303(e) of the Freddie Mac Act and section 309(c)(2) of the Fannie Mae Charter Act).

While the securities that the GSEs guarantee, and the debt instruments they issue, are explicitly not backed by the full faith and credit of the United States, and nothing in this rule should be construed otherwise, such securities and instruments trade at yields only a few basis points over those of U.S. Treasury securities with comparable terms. These securities also offer yields lower than those for securities issued by fully private firms that are more highly capitalized but otherwise comparable. In addition, the market does not require that individual GSE securities be rated by a national rating agency. Consequently, the GSEs are able to fund their operations at lower cost than other private firms with similar financial characteristics. In a recent report, the Congressional Budget Office (CBO) estimated that this funding advantage for the year 2003 resulted in a \$19.6 billion annual combined subsidy for both GSEs. Of this amount, CBO estimated that the GSEs retained about \$6.2 billion, or approximately one-third of the subsidy, for their officers and

<sup>1</sup> Fannie Mae and Freddie Mac have both announced their intention voluntarily to register their common stock with the Securities and Exchange Commission (SEC) under section 12(g) of the Securities Exchange Act of 1934. Fannie Mae's registration became effective March 31, 2003. Freddie Mac has stated that it will complete the process of voluntarily registering its common stock once it resumes timely reporting of its financial results.

shareholders, while the remainder accrued to borrowers.<sup>2</sup>

In return for the public benefits they receive, Congress has mandated in the GSEs' Charter Acts that the GSEs carry out public purposes not required of other private sector entities in the housing finance industry. These statutory mandates obligate the GSEs to work to ensure that everyone in the nation has a reasonable opportunity to enjoy access to the mortgage financing benefits resulting from the activities of these enterprises.

With respect to these public purposes, Congress does not simply expect the GSEs to strive toward achievement of these purposes but rather to "lead the mortgage finance industry" and to "ensure that citizens throughout the country enjoy access to the public benefits provided by these federally related entities." (See S. Rep. No. 102-282, at 34 (1992).)

### C. Statutory and Regulatory Background

The statutory and regulatory background applicable to the chartering of Fannie Mae and Freddie Mac and HUD's regulatory authority over these two GSEs were set out in detail in the preamble to HUD's proposed rule published on May 3, 2004 (69 FR 24228). Therefore, this background information is not repeated here in the preamble to this final rule. Interested members of the public should refer to Section I.A. of the preamble to the proposed rule at pages 69 FR 24228 through 69 FR 24230 for this information.

### D. The Proposed Rule

On May 3, 2004, HUD published a proposed rule setting forth new housing goal levels for Fannie Mae and Freddie Mac. (See 69 FR 24228.) HUD's rule proposed to increase the level of the housing goals ("Housing Goals") for the purchase by Fannie Mae and Freddie Mac of mortgages financing low- and moderate-income housing, special affordable housing, and housing in central cities, rural areas, and other underserved areas. The rule also proposed to establish new subgoals for the GSEs' acquisitions of home purchase

loans that qualify for each of the housing goals.

In addition to soliciting public comments on the proposed goal levels and new subgoals, the rule solicited public comments on several other issues related to the housing goals, including: (1) Provisions relating to GSE data integrity, such as verification, certification, treatment of errors, omissions or discrepancies, and other enforcement authority; (2) amended definitions of "underserved area," "metropolitan area" and "minority," and a new definition of the term "home purchase mortgage"; (3) a method for imputing the distribution of GSE-purchased mortgages that lack income data; and (4) other changes related to the GSEs' bulk purchases of seasoned loans. More detailed information about HUD's proposals can be found in the preamble to HUD's May 3, 2004, proposed rule.

### E. This Final Rule—Overview

Under this 2004 rulemaking, the Department is setting new, higher levels for the Housing Goals, accompanied by subgoals under each of the Housing Goals for purchases of home purchase mortgages (*i.e.*, excluding refinance mortgages) on owner-occupied properties in metropolitan areas. (The subgoals are referred to in this rule as the "Home Purchase Subgoals.")

The Department's purpose in setting higher Housing Goals and in establishing new Home Purchase Subgoals in this final rule is to encourage the GSEs to facilitate greater financing and homeownership opportunities for families and neighborhoods targeted by the Housing Goals. The final rule establishes levels of the Housing Goals that will bring the GSEs to a position of market leadership in a range of foreseeable economic circumstances related to the future course of interest rates and consequent fluctuations in origination rates on home purchase and refinance mortgages—both multifamily and single-family.

For each goal, HUD has projected goal-qualifying percentages of mortgage originations in terms of ranges that cover a variety of economic scenarios. The objective of HUD's Housing Goals is to bring the GSEs' performance to the upper end of HUD's market range estimate for each goal, consistent with the requirement in FHEFSSA that HUD should consider the GSEs' ability to lead the market for each goal.

To enable the GSEs to achieve this leadership, the Department has established staged increases in Housing Goal levels for 2005, which will increase further, year-by-year through

2008, to achieve the ultimate objective for the GSEs to lead the market under a range of foreseeable economic circumstances by 2008.

The staged increases established by this rule, are consistent with the statutory requirement that HUD consider the past performance of the GSEs in setting the Housing Goals. Staged annual increases in the Goals will provide the GSEs with the opportunity to adjust their business models, so as to meet the required 2008 levels without compromising other business objectives and requirements.

The Department believes that the Home Purchase Subgoals established by this final rule are necessary and warranted. Increasing homeownership is a national priority. The past average performance of the GSEs in the home purchase market has been below market levels. As further discussed below, the GSEs must apply greater efforts to increasing homeownership for low- and moderate-income families, families living in underserved areas, and very-low income families and low-income families living in low-income areas. The addition of Home Purchase Subgoals to the regulatory structure will serve to better focus the GSEs' efforts in a clear and transparent manner. The Home Purchase Subgoals will better allow the government and public alike to monitor the GSEs' efforts in meeting the nation's homeownership needs. The increases in the levels of the Housing Goals, and the addition of the new Home Purchase Subgoals, are predicated upon the Department's recognition that the GSEs not only have the ability to achieve these Housing Goals and Subgoals but, also, that they are fully consistent with the statutory factors established under FHEFSSA. In addition, this rule is supported by the Department's comprehensive analyses of the size of the mortgage market, the opportunities available to the GSEs, America's unmet housing needs, and identified credit gaps.

In addition to the establishment of higher Housing Goals for the years 2005 through 2008, and the establishment of Home Purchase Subgoals, specific changes included in the final rule from the provisions included in the May 3, 2004, proposed rule are as follows:

(1) The final rule expands the existing provisions to permit the GSEs to impute incomes or rents when data are missing for some purchases, addressing the market's expanding use of low documentation mortgages;

(2) The final rule provides that goals credit is available for purchases of loans in transactions involving seller dissolution options, such as repurchase

<sup>2</sup> "Updated Estimates of the Subsidies to the Housing GSEs," attachment to a letter from Douglas Holtz-Eakin, Director, Congressional Budget Office, to the Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate, April 8, 2004. A related recent study is Wayne Passmore, "The GSE Implicit Subsidy and Value of Government Ambiguity," Board of Governors of the Federal Reserve System. Finance and Economics Discussion Series, FEDS Working Paper 2003-64, December 2003.

agreements, only when the option provides for a minimum one-year lockout period;

(3) The final rule clarifies the proposed provisions regarding HUD's procedures for correcting errors, omissions and discrepancies in current year-end data and in remedying material overstatements of housing goals performance for prior years;

(4) The final rule changes the scope of the proposed certification statement that the GSEs must provide to make it closer to the certification used by the Office of Federal Housing Enterprise Oversight (OFHEO), the GSEs' financial safety and soundness regulator; and

(5) The final rule makes a technical correction to the special counting rules prohibiting double counting of GSE purchases of seasoned mortgages toward the housing goals.

In developing these regulations, the Department was guided by, and reaffirms, the following principles established in the Housing Goals 1995 final rule (published on December 1, 1995 at 60 FR 1846):

(1) The GSEs should fulfill FHEFSSA's intent that they lead the industry in ensuring that access to mortgage credit is made available for very low-, low- and moderate-income families and residents of underserved areas. HUD recognizes that, to lead the mortgage industry over time, the GSEs will have to stretch to reach certain Housing Goals and to close gaps between the secondary mortgage market and the primary mortgage market for various categories of loans. This recognition is consistent with the Congressional directive that "the enterprises will need to stretch their efforts to achieve" the goals. (*See* S. Rep. No. 102-282, at 35 (1992).)

(2) The Department's role as a regulator is to set broad performance standards for the GSEs through the Housing Goals, but not to dictate the specific products or delivery mechanisms the GSEs will use to achieve a Housing Goal. Regulating two exceedingly large financial enterprises in a dynamic market requires that HUD provide the GSEs with sufficient latitude to use their innovative capacities to determine how best to develop products to carry out their respective missions. HUD's regulations are intended to allow the GSEs the flexibility to respond quickly to market opportunities. At the same time, the Department must ensure that the GSEs' strategies address national credit needs, especially as they relate to housing for low- and moderate-income families and housing located in underserved geographical areas. The addition of

Home Purchase Subgoals to the regulatory structure provides an additional means of encouraging the GSEs' affordable housing activities to address identified, persistent credit needs while leaving to the GSEs the specific approaches used to meet these needs.

(3) Discrimination in lending continues to limit access to credit for purchasing homes by racial and ethnic minorities. Troublesome gaps in homeownership remain for minorities even after record growth in affordable lending and homeownership during the nineties. Studies indicate that, over the next few years, minorities will account for a growing share of the families seeking to buy their first home. HUD's analyses indicate, however, that Fannie Mae and Freddie Mac account for a disproportionately small share of the minority first-time homebuyer market. The GSEs have a responsibility to promote access to capital for minorities and others who are seeking their first homes, and to demonstrate the benefits of such lending to industry and borrowers alike. The GSEs also have an integral role in eliminating predatory mortgage lending practices.

(4) In addition to the GSEs' purchases of single-family home mortgages, the GSEs also must continue to assist in the creation of an active secondary market for mortgages on multifamily rental housing. Affordable rental housing is essential for those families who cannot afford to become, or who choose not to become, homeowners. For this reason, the GSEs must assist in making capital available to assure the continued development of single-family and multifamily rental housing.

## II. Discussion of Public Comments

### A. Overview of Public Comments

At the close of the public comment period on July 16, 2004, which was extended an additional two weeks beyond the original public comment deadline of July 2, 2004, HUD had received 302 comments, which are in HUD's docket file for this rule. In addition to the public comments received on the rule, during the public comment period, HUD met with representatives of several organizations, including Fannie Mae and Freddie Mac, to accommodate oral presentation of concerns about the rule. HUD's docket file for this rule contains information on the dates of these meetings, the attendees, and the subject discussed.

Of the public comments received on the proposed rule, the most detailed comments were those submitted by the two directly affected GSEs, Fannie Mae

and Freddie Mac. Neither GSE was supportive of the higher goal levels proposed for 2005–2008, nor did either support the creation of HUD's proposed Home Purchase Subgoals. The GSEs stated, among other comments that they made on the rule, that the effect of many goals and subgoals would be micromanagement of the GSEs. With their comments, the GSEs provided several appendices that provided alternative analyses of data and questioned the Department's methodology in determining market share for the three affordable housing goals, a key component for establishing the appropriate level of the housing goals and the subgoals.

The GSEs did not object to HUD's special affordable multifamily subgoal levels for 2005–2008, but other commenters (mostly public advocacy groups) recommended that HUD increase the levels of these subgoals.

In addition to the GSEs, the commenters included national and regional housing industry organizations, nonprofit organizations, alliances, councils, and advocacy organizations involved in housing or housing issues, lenders, academic researchers, Members of Congress, state and local government officials, and two individuals.

In large measure, except for several nonprofit organizations and public advocacy groups that favored higher goals, the majority of commenters were not supportive of HUD's proposed goals, especially in the outer years when the goal levels would reach their highest levels. A particular concern cited by a number of commenters was the potential for adverse impact on middle-income borrowers, particularly higher interest rates and fees. Another concern raised by the commenters was the possibility of unintended consequences for the industry. Many commenters, including the GSEs, urged HUD to exclude all single-family refinances from the calculation of the goals.

The Department received fewer comments that addressed other proposals in the rule, such as those regarding data integrity, large-scale transactions involving seasoned loans, the treatment of missing income data, and modifying the definition of rural underserved areas. For those commenters who submitted comments on these proposals, the reactions were generally mixed.

With respect to HUD's proposals for new data integrity provisions, the majority of those who commented on the new data integrity proposals were generally supportive of the concept and acknowledged the need for some sort of data verification process. However, two

industry-related commenters expressed concern about the potential for HUD's proposals to result in increased reporting burdens for lenders. The GSEs' comments also reflected several concerns about the data integrity provisions, mainly with respect to definitions, procedures, and enforcement.

The GSEs favored generous proxy provisions for the treatment of missing income data and submitted several suggestions. The majority of commenters on this issue, consisting chiefly of nonprofit and advocacy organizations, opposed using proxies, and several favored an outright ban on purchasing "no income" subprime mortgages.

With regard to large-scale transactions involving seasoned loans, the GSEs commented that they should receive housing goals credit and that no change in HUD's current definition of "mortgage purchase" was warranted. However, a group of industry-related organizations opposed providing goals credit for seasoned loans, as did several advocacy organizations. Commenters offered no alternative definitions for "mortgage purchase" in HUD's regulations.

All but one commenter who addressed the issue of HUD's rural underserved area definition favored changing this definition to one that is census tract-based, rather than county-based. Those commenters favoring conversion to a tract-based definition believed that county-level data do not show disparities in service that the GSEs should address. The dissenting commenter felt that lenders serving rural areas would face operational difficulties and expenses in shifting to a tract-based orientation.

In addition to comments on its proposals related to housing goals, HUD received other comments on subjects pertaining to HUD's regulatory authority over the GSEs but which were not related to the rule's proposals on housing goals (for example, comments on new program authority, monitoring and reporting procedures, and public access to GSE mortgage data). Because these comments raised issues outside the scope of the May 3, 2004, proposed rule, they are not addressed in this final rule.

A discussion of the general and specific comments on the rule, as well as HUD's responses to these comments, follows in subsequent sections in this preamble, as well as in the Appendices to this Final Rule. While comments are summarized, not all the comments are addressed explicitly in this preamble. HUD is appreciative of the full range of

public comments received and acknowledges the value of all of the comments submitted in response to the proposed rule.

#### *B. Subpart A—General*

In the May 3, 2004, rule, HUD proposed to add a definition of "home purchase mortgage" in connection with its proposal to specify Home Purchase Subgoals under each of the three Housing Goals, to revise the definitions of "metropolitan area" and "minority" to conform HUD's regulations to changes in data collection practices made by the Office of Management and Budget (OMB), and to modify the current definition of "underserved area" with respect to the delineation of underserved portions of non-metropolitan areas.

##### 1. Home Purchase Mortgage

HUD proposed to insert a definition of "home purchase mortgage" for purposes of specifying the Home Purchase Mortgage Subgoals. Since no comments bearing directly on this definition were received and the Department has retained the subgoal concept in this final rule, the definition is adopted.

##### 2. Metropolitan Area

HUD proposed to alter the definition of "metropolitan area" to reflect a change in the definition of "metropolitan area" recently promulgated by OMB, in which the concept of "Primary Metropolitan Statistical Area" was removed. No comments were received on this proposed change; accordingly, it is adopted.

##### 3. Minority

HUD proposed to alter the definition of "minority" to reflect changes in standards for the classification of federal data on race and ethnicity previously promulgated by OMB and implemented in the 2000 census and in data collection under the Home Mortgage Disclosure Act in 2004. No comments were received on this proposed change; accordingly, it is adopted.

##### 4. Underserved Area

HUD proposed to alter the definition of "underserved area" to provide for the specification of underserved areas outside of metropolitan areas at the census tract level rather than at the county level.

For properties in non-metropolitan (rural) areas, mortgage purchases have counted toward the Underserved Areas Housing Goal where such purchases finance properties that are located in underserved counties. This final rule

incorporates a determination that mortgage purchases will count toward the Underserved Areas Housing Goal where such purchases finance properties that are located in underserved census tracts. These are defined as census tracts where either: (1) the median income in the tract does not exceed 95 percent of the greater of the median income for the non-metropolitan portions of the state or the median income of the non-metropolitan portions of the nation as a whole; or (2) minorities comprise at least 30 percent of the residents and the median income in the tract does not exceed 120 percent of the greater of the median incomes for the non-metropolitan portions of the state or of the nation as a whole.

HUD originally adopted its current county-based definition for targeting GSE purchases to underserved non-metropolitan areas primarily based on information that rural lenders did not perceive their market areas in terms of census tracts, but rather, in terms of counties. A further concern was an apparent lack of reliability of geocoding software applied to non-metropolitan areas.

Thirteen commenters endorsed HUD's proposed change in definition, observing that the change would produce more precise targeting and improved service toward underserved segments of the market within counties. One banking trade association advocated continuation of a county-based definition, stating that because the business perspective of community banks in rural areas is geared toward entire counties, there would be costs associated with monitoring the tract location of loans, and therefore, marketing toward borrowers at the tract level would be difficult.

Recent research summarized in Appendix B to this rule indicates that a tract-based system will improve the extent to which the underserved area definition distinguishes areas by key socioeconomic and demographic characteristics such as median family income, poverty, unemployment, school dropout rates, and minority populations. Under a tract-based definition underserved areas stand out more as areas of lower income and low economic activity and as having somewhat larger minority population proportions. A tract-based definition will also improve the targeting of the goal to areas with relatively greater housing needs. Based on these findings, which are detailed in Appendix B to this rule, HUD is adopting a re-specification of underserved areas within non-metropolitan (rural) areas to

be based on census tracts rather than counties.

### C. Subpart B—Housing Goals

#### 1. Overview

A substantial majority of the comments received criticized HUD's proposed levels of the housing goals on the basis that they would be difficult for the GSEs to achieve, particularly in periods of high refinance activity when higher-income borrowers comprise a relatively high proportion of mortgage borrowers. Several types of adverse consequences of such high goals were forecast, including diminution of availability of mortgage credit to some sectors of the mortgage market, unfavorable effects on neighborhood housing quality, and other adverse effects discussed below. This section of the final rule reviews the statutory factors the Department must consider in setting the level of the housing goals and the Department's determinations with regard to the levels of each of the housing goals as well as the proposed Home Purchase Subgoals.

#### 2. Statutorily Required Factors in Setting the Levels of the Housing Goals and Subgoals

The Housing Goals and Home Purchase Subgoals being implemented by this final rule were established following consideration of the six factors required by statute to be considered in establishing goal levels and establishing subgoals. A summary of HUD's findings relative to each of the six statutory factors follows. More detailed discussion of these points is included in Appendices A, B, and C to this rule.

#### a. Demographic, Economic, and Housing Conditions

##### (i) Demographic Trends

Changing population demographics will result in a need for the primary and secondary mortgage markets to meet nontraditional credit needs, respond to diverse housing preferences and overcome information and other barriers that many immigrants and minorities currently face.

The U.S. Census Bureau has projected that the U.S. population will grow by an average of 2.5 million persons per year between 2000 and 2025, resulting in about 1.2 million new households per year. The aging of the baby-boom generation and the entry of the baby-bust generation into prime home-buying age will have a dampening effect on housing demand. Growing housing demand from minorities, immigrants and non-traditional homebuyers will

help offset declines in the demand for housing caused by the aging of the population.

The continued influx of immigrants will increase the demand for rental housing, while those who immigrated during the 1980s and 1990s will be in the market for homeownership. Immigrants and minorities—who accounted for nearly 40 percent of the growth in the nation's homeownership rate over the past five years—will be responsible for almost two-thirds of the growth in the number of new households over the next 10 years.

Non-traditional households have become more important, as overall household formation rates have slowed. With later marriages, divorce, and non-traditional living arrangements, the fastest growing household groups are single-parent and single-person households. By 2025, non-family households will make up one-third of all households. The role of traditional 25-to-34 year-old married, first-time homebuyers in the housing market will be smaller in the current decade due to the aging of the population. Between 2000 and 2025, the Census Bureau projects that the largest growth in households will occur among householders who are age 65 and older.

As these demographic factors play out, the overall effect on housing demand will likely be continued growth and an increasingly diverse household population from which to draw new renters and homeowners. A greater diversity in the housing market will, in turn, require greater adaptation by the primary and secondary mortgage markets.

##### (ii) Economic and Housing Conditions

While most other sectors of the economy were weak or declining during 2001 and 2002, the housing sector showed remarkable strength. The housing market continued at a record pace during 2003.

In 2002, the U.S. economy moved into recovery, with real Gross Domestic Product (GDP) growing 2.2 percent, although measures of unemployment continued to rise before declining again in 2003. In October 2002, the average 30-year home mortgage interest rate slipped below 6 percent for the first time since the mid-1960s. Favorable financing conditions and solid increases in house prices were the key supports to record housing markets during both 2002 and 2003. By the end of 2003, the industry had set new records in single-family home permits, new home sales, existing home sales, low interest rates, and rates of homeownership. Other indicators—total permits, starts,

completions, and affordability—reached levels that were among the highest in the past two decades.

The Administration's forecast for real GDP growth is 3.7 percent for 2005 and 3.1–3.4 percent in 2006–2009, while CBO projects that real GDP will grow at an average rate of 4.1 percent in 2005 and annual rates of 2.9–3.2 percent in 2006 through 2009.<sup>3</sup> The Administration projects the 10-year Treasury rate to average 5.1 percent in 2005 and 5.4–5.8 percent between 2006 and 2009 compared to its average of 4.6 percent in 2002 and 4.0 percent in 2003.

Standard & Poor's expects housing starts to average 1.8 million units in 2004–2005. Fannie Mae projects existing home sales for 2004 at 6.1 million units, and for 2005 at 5.8 million, compared to their record level in 2003 of 6 million units.

##### (iii) Mortgage Market Conditions

Low interest rates and record levels of refinancing caused mortgage originations to soar from \$2.0 trillion in 2001 to \$2.6 trillion in 2002 and around \$3.8 trillion in 2003. The Mortgage Bankers Association projects that mortgage originations will drop to \$2.7 trillion in 2004 and \$1.8 trillion in 2005, as refinancing returns to more normal levels.<sup>4</sup>

The volume of home purchase mortgages was \$910 billion to \$1.1 trillion between 1999 and 2001 before jumping to \$1.2 trillion in 2002 and \$1.3 trillion in 2003. As with housing starts, the home purchase origination market is expected to exhibit sustained growth.

#### b. National Housing Needs

##### (i) Affordability Problems

Data from the 2000 Census and the American Housing Survey demonstrate that there are substantial housing needs among low- and moderate-income families. Many of these households are burdened by high homeownership costs or rent payments and, consequently, are facing serious housing affordability problems. There is evidence of persistent housing problems for Americans with the lowest incomes. Since 1977 the percentage of U.S. households with worst case needs has hovered around five percent, with the worst year being 1983 (6.03 percent) and the best being 1999 (4.72 percent). The

<sup>3</sup> Fiscal Year 2005 Budget of the U.S. Government: Mid-Session review (July 30, 2004). Office of Management and Budget, also posted at <http://www.whitehouse.gov/omb>. The Budget and Economic Outlook: An Update, Washington, Congressional Budget Office, September 2004, also posted on <http://www.cbo.gov>.

<sup>4</sup> Mortgage Bankers Association of America, MBA Mortgage Finance Forecast, September 17, 2004.

proportion in 2001 was 4.77 percent, which is not significantly different from the 1999 figure. HUD's analysis of American Housing Survey data reveals that, in 2001, 5.1 million unassisted very-low-income renter households had "worst case" housing needs, defined as housing costs greater than 50 percent of household income or severely inadequate housing. Among these households, 90 percent had a severe rent burden, 6 percent lived in severely inadequate housing, and 4 percent suffered from both problems. Among the 34 million renters in all income categories, 6.3 million (19 percent) had a severe rent burden and over one million renters (3 percent) lived in housing that was severely inadequate.

(ii) Disparities in Housing and Mortgage Markets

Despite the strong growth in affordable lending over the past ten years, there are families who are not being adequately served by the nation's housing and mortgage markets. Serious racial and income disparities remain. The homeownership rate for minorities is 25 percentage points below that for whites. A major HUD-funded study of discrimination in the sales and rental markets found that discrimination still persists in both rental and sales markets of large metropolitan areas nationwide, although its incidence has generally declined since 1989. The most prevalent form of discrimination observed in the study against Hispanic and African-American home seekers was Hispanics and African Americans being told that housing units were unavailable when non-Hispanic whites found them to be available. Levels of consistent adverse treatment experienced by the nation's largest minority groups when they inquire about a unit advertised for sale in metropolitan areas nationwide in 2000–2001 were: African Americans 16.8 percent, Hispanics 18.3 percent, and Asians and Pacific Islanders 20.4 percent.

The study also found other worrisome trends of discrimination in metropolitan housing markets that persisted in 2000. Examples include geographical steering experienced by African-American homebuyers, and real estate agents who provided less assistance in obtaining financing for Hispanic homebuyers than for non-Hispanic whites.<sup>5</sup> Racial disparities in mortgage lending are also well documented. HUD-sponsored studies of the pre-qualification process

conclude that African Americans and Hispanics risk unequal treatment when they visit mainstream mortgage lenders. Studies reveal higher mortgage denial rates for African Americans and Hispanics, even after controlling for applicant income and a host of underwriting characteristics, such as the credit record of the applicant.<sup>6</sup> However, substantial progress has been made since 1989.

The existence of substantial neighborhood disparities in homeownership and mortgage credit is also well documented for metropolitan areas. HUD's analysis of Home Mortgage Disclosure Act (HMDA) data shows that mortgage credit flows in metropolitan areas are substantially lower in high-minority and low-income neighborhoods and that mortgage denial rates are much higher for residents of these neighborhoods. Studies have also documented that mainstream lenders often do not operate in inner-city minority neighborhoods, leaving their residents with only high-cost lenders as options. Too often, residents of these same neighborhoods have been subjected to the abusive practices of predatory lenders.

These troublesome disparities mostly affect those families (minorities and immigrants) who are projected to account for almost two-thirds of the growth in the number of new households over the next 10 years.

(iii) Single-Family Market: Trends in Affordable Lending and Homeownership

Many younger, minority and lower-income families did not become homeowners during the 1980s due to slow growth of some earnings, high real interest rates, lower inflation, and continued increases in housing prices. Over the past 10 years, economic expansion, accompanied by low interest rates and increased outreach on the part of the mortgage industry, has improved affordability conditions for these families.

As this preamble and the appendices note, there has been a "revolution in affordable lending" that has extended homeownership opportunities to historically underserved households. The mortgage industry, including the GSEs, has offered more customized mortgage products, more flexible underwriting, and expanded outreach to low-income and minority borrowers.

HMDA data suggest that the industry and GSE initiatives are increasing the flow of credit to underserved borrowers.

Between 1993 and 2002, conventional loans to low-income and minority families increased at much faster rates than loans to upper-income and non-minority families. Conventional home purchase originations to African Americans more than doubled between 1993 and 2002, and those to Hispanic borrowers more than tripled during this period. Home loans to low-income borrowers and to low-income and high-minority census tracts also more than doubled during this period.

Thus, the 1990s and the early part of the current decade have seen the development of a strong affordable lending market. Homeownership statistics show similar trends. After declining during the 1980s, the homeownership rate has increased every year since 1994, reaching a record mark of 69.2 percent in the second quarter of 2004.

The number of households owning their own home increased by 13.3 million between 1994 and 2003. Gains in homeownership rates during the period of 1994 to 2003 have been widespread, with the homeownership rate for African-American households increasing from 42.5 percent to 48.8 percent, for Hispanic households from 41.2 percent to 46.7 percent, for non-Hispanic white households from 70.0 percent to 75.4 percent, and for central city residents from 48.5 percent to 52.3 percent.

Despite the record gains in homeownership since 1994, a gap of approximately 25 percent in the homeownership rate prevails for African-American and Hispanic households as compared to white non-Hispanic households. Studies show that these lower homeownership rates are only partly accounted for by differences in income, age, and other socioeconomic factors.

In addition to low income, barriers to homeownership that disproportionately affect minorities and immigrants include: lack of capital for downpayment and closing costs; poor credit history; lack of access to mainstream lenders; little understanding of the home buying process; a limited supply of modestly priced homes in locations where these populations reside; and continued discrimination in housing markets and mortgage lending. These barriers are discussed in Appendix A to this rule.

(iv) Single-Family Market: Potential Homeowners

As already noted, the potential homeowner population over the next decade will be highly diverse, as growing housing demand from

<sup>5</sup> Margery Austin Turner, *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions*, The Urban Institute Press, April 2002. Appendix A includes further discussion of this study.

<sup>6</sup> These studies are discussed in section B.1 of Appendix B.

immigrants (both those who are already in this country and those who are projected to arrive), minorities, and non-traditional homebuyers will help to offset declines in the demand for housing caused by the aging of the population.

Studies cited in Appendix A to this rule reveal that increased immigration during the 1990s directly accounted for 35 percent of the nation's rise in population during that decade, as a result of which the foreign-born population of the United States was 31.1 million in 2000. These trends do not depend on the future inflow of new immigrants, as immigrants do not, on average, enter the home purchase market until they have been in this country for eleven years. Fannie Mae staff have noted that there are enough immigrants already in this country to keep housing demand strong for several years.

Thus, the need for the GSEs and other industry participants to meet nontraditional credit needs, respond to diverse housing preferences, and to overcome the information barriers that many immigrants face will take on added importance. A new or recent immigrant may have no credit history or, at least, may not have a credit history that can be documented by traditional methods. In order to address these needs, the GSEs and the mortgage industry have been developing innovative products and seeking to extend their outreach efforts to attract these homebuyers, as discussed in Appendix A to this rule.

In addition, the current low homeownership rates in inner cities (as compared with the suburbs) also suggest that urban areas may be a potential growth market for lenders. As explained in Appendix A to this rule, lenders are beginning to recognize that urban borrowers and properties have different needs than suburban borrowers and properties.

Surveys indicate that these demographic trends will be reinforced by the fact that most Americans desire, and plan, to become homeowners. According to Fannie Mae's 2002 National Housing Survey, Americans rate homeownership as the best investment they can make, far ahead of 401(k) plans, other retirement accounts, and stocks. Forty-two percent of African-American families reported that they were "very or fairly likely" to buy a home in the next three years, up from 38 percent in 1998 and 25 percent in 1997. Among Hispanics and Hispanic immigrants, the numbers reached 37 percent and 34 percent, respectively. The survey also reported that more than

half of Hispanic renters cite homeownership as being "one of their top priorities."

Despite these trends, potential minority and immigrant homebuyers see more obstacles to buying a home than does the general public. Typically, the primary barriers to homeownership are credit issues and a lack of funds for a downpayment and closing costs. However, other barriers also exist, such as a lack of affordable housing, little understanding of the home buying process, and language barriers. Thus, the new group of potential homeowners will have unique needs.

The GSEs can play an important role in tapping this potential homeowner population. Along with others in the industry, they can address these needs on several fronts, such as expanding education and outreach efforts, introducing new products, and adjusting current underwriting standards to better reflect the special circumstances of these new households. These efforts are necessary for achieving the Administration's goal of expanding minority homeownership by 5.5 million families by the end of the decade.

The single-family mortgage market has been very dynamic over the past few years, experiencing volatile swings in originations (with the 1998 and 2001–2003 refinancing waves), witnessing the rapid growth in new types of lending (such as subprime lending), incorporating new technologies (such as automated underwriting systems), and facing serious challenges (such as predatory lending). Fannie Mae and Freddie Mac have played a major role in the ongoing changes in the single-family market and in helping the industry address the problems and challenges that have arisen.

The appendices to this final rule discuss the various roles that Fannie Mae and Freddie Mac have played in the single-family market. A wide range of topics is examined, including the GSEs' automated underwriting technology used throughout the industry, their many affordable lending partnerships and underwriting initiatives aimed at extending credit to underserved borrowers, their development of new targeted low-downpayment products, their entry into new markets such as the subprime market, and their attempts to reduce predatory lending. As that discussion emphasizes, the GSEs have the ability to bring increased efficiencies to a market and to attract mainstream lenders into markets. (Readers are referred to Appendices A, B, and C to this rule for further discussion of the GSEs' role in

different segments of the single-family mortgage market.)

#### (v) Multifamily Mortgage Market

The market for financing of multifamily apartments has reached record volume. The favorable long-term prospects for apartments, combined with record low interest rates, have kept investor demand for apartments strong and have supported property prices despite recently high vacancy rates.

Fannie Mae and Freddie Mac have been among those boosting their volumes of multifamily financing and both have introduced new programs to serve the multifamily market. Fannie Mae and, especially (considering its earlier withdrawal from the market), Freddie Mac have rapidly expanded their presence in the multifamily mortgage market under the Housing Goals.

Freddie Mac has successfully rebuilt its multifamily acquisition program, as reflected by the increase in its purchases of multifamily mortgages: from \$27 million in 1992 to \$3.9 billion in 1998 and then rising to \$9.5 billion in 2001, \$10.7 billion in 2002, and \$21.5 billion in 2003. Multifamily units accounted for 9.0 percent of all dwelling units (both owner and rental) financed by Freddie Mac between 1999 and 2003. Concerns regarding multifamily capabilities no longer constrain Freddie Mac's performance with regard to the Housing Goals.

Although Fannie Mae never withdrew from the multifamily market, it has stepped up its activities in this area substantially, with multifamily purchases rising from \$3.0 billion in 1992 to \$10.0 billion in 1999, and \$19.1 billion in 2001, then declining slightly to \$16.6 billion in 2002, and then rising markedly to \$30.9 billion in 2003. Multifamily units accounted for 8.8 percent of all dwelling units (both owner and rental) financed by Fannie Mae between 1999 and 2003.

The increased role of Fannie Mae and Freddie Mac in the multifamily market has major implications for the Low- and Moderate-Income Housing and Special Affordable Housing Goals, since high percentages of multifamily units have affordable-level rents and can count toward one or both of these Housing Goals. However, the potential of the GSEs to lead the multifamily mortgage industry has not been fully developed. The GSEs' purchases between 1999 and 2002 accounted for less than 40 percent of the multifamily units that received financing during this period. Certainly there are ample opportunities and room for expansion of the GSEs' share of the multifamily mortgage market.

The GSEs' size and market position between loan originators and mortgage investors make them the logical institutions to identify and promote needed innovations and to establish standards that will improve market efficiency. As their role in the multifamily market continues to grow, the GSEs will have the knowledge and market presence to push simultaneously for standardization and for programmatic flexibility to meet special needs and circumstances, with the ultimate goal of increasing the availability and reducing the cost of financing for affordable and other multifamily rental properties.

The long-term outlook for the multifamily rental market is sustained, moderate growth, based on favorable demographics. The minority population, especially Hispanics, provides a growing source of demand for affordable rental housing. "Lifestyle renters" (older, middle-income households) are also a fast-growing segment of the rental population.

At the same time, the provision of affordable housing units will continue to challenge suppliers of multifamily rental housing as well as policy makers at all levels of government. Low incomes, combined with high housing expenses, define the difficult situation of millions of renter households. Housing cost reductions are constrained by high land prices and construction costs in many markets. Regulatory barriers at the state and local level have an enormous impact on the development of affordable rental housing. Government action—through land use regulation, building codes, and occupancy standards—is a major contributor to high housing costs.

Since the early 1990s, the multifamily mortgage market has become more closely interconnected with global capital markets, although not to the same degree as the single-family mortgage market. Loans on multifamily properties are still viewed as riskier by some than are mortgages on single-family properties, despite delinquency rates that in recent quarters have been lower than those on single-family mortgages.

There is a need for an ongoing GSE presence in the multifamily secondary market, both to increase liquidity and to advance affordable housing efforts. The potential for an increased GSE presence is enhanced by the fact that an increasing proportion of multifamily mortgages are now originated in accordance with secondary market standards. Small multifamily properties, and multifamily properties with significant rehabilitation needs, have

historically experienced difficulty gaining access to mortgage financing, and the flow of capital into multifamily housing for seniors has been historically characterized by volatility. The GSEs can play a role in promoting liquidity for multifamily mortgages and increasing the availability of long-term, fixed-rate financing for these properties.

#### c. GSEs' Past Performance and Effort Toward Achieving the Housing Goals

Since the enactment of FHEFSSA and HUD's establishment in 1993 of the Housing Goals, both Fannie Mae and Freddie Mac have improved their affordable housing loan performance. However, the GSEs' mortgage purchases have generally lagged, and not led, the overall primary market in providing financing for affordable housing to low- and moderate-income families and underserved borrowers and their neighborhoods, indicating that there is more that the GSEs can do to improve their performance.

##### (i) Performance on the Housing Goals

The year 2001 was the first year under the higher levels of the Housing Goals established in the Housing Goals 2000 final rule. Fannie Mae met all three Housing Goals in 2001, 2002, and 2003. Freddie Mac met all three Housing Goals in 2001 and 2003. However, in 2002 HUD discovered that Freddie Mac had counted 22,371 housing units towards the Low- and Moderate Income Goal even though it had previously counted these same housing units towards the same goal in 2001. Freddie Mac also counted 22,424 housing units towards the Underserved Area Goal even though these units had also been credited towards the same goal in 2001. HUD's regulations prohibit double counting. To correct for these double-counting errors, the Department has adjusted its official performance results for Freddie Mac in 2002 by deducting the double-counted housing units, including all bonus point credit that had been awarded for most of these units, from the official performance results it had previously reported publicly. As a result of these adjustments, Freddie Mac continued to meet the Low- and Moderate-Income Goal in 2002. However, Freddie Mac fell short of the 31 percent target for the Underserved Areas goal by 90 units or 0.002 percent. Freddie Mac's 2002 goal performance results are described more fully in Tables 4, 6 and 8 in this preamble, including the accompanying footnotes.

##### (ii) The GSEs' Efforts in the Home Purchase Mortgage Market

The Appendices to this final rule include a comprehensive analysis of each GSE's performance in funding home purchase mortgages for borrowers and neighborhoods targeted by the three Housing Goals—special affordable and low- and moderate-income borrowers and underserved areas. The GSEs' role in the first-time homebuyer market is also analyzed. Because homeownership opportunities are integrally tied to the ready availability of affordable home purchase loans, the main findings from that analysis are provided below.

- Both Fannie Mae and Freddie Mac have increased their purchases of affordable home purchase mortgages since the Housing Goals were put into effect, as indicated by the increasing share of their business going to the three goals-qualifying categories. Between 1992 and 2003, the special affordable share of Fannie Mae's business almost tripled, rising from 6.3 percent to 17.1 percent, while the underserved areas share increased more modestly, from 18.3 percent to 26.8 percent. The figures for Freddie Mac are similar. The special affordable share of Freddie Mac's business rose from 6.5 percent to 15.6 percent, while the underserved areas share also increased but more modestly, from 18.6 percent to 24.0 percent.

- While both GSEs improved their performance, they have historically lagged the primary market in providing affordable home purchase mortgage loans to low-income borrowers and underserved neighborhoods. Freddie Mac's average performance, in particular, fell far short of market performance during the 1990s. Fannie Mae's average performance was better than Freddie Mac's during the 1993–2003 period as well as during the 1996–2003 period, which covers the period under HUD's currently-defined Housing Goals. Between 1993 and 2003, 12.2 percent of Freddie Mac's mortgage purchases were for special affordable borrowers, compared with 13.3 percent of Fannie Mae's purchases, 15.4 percent of loans originated by depositories, and 15.5 percent of loans originated in the conventional conforming market (without estimated B&C subprime loans).<sup>7</sup>

<sup>7</sup> Unless otherwise noted, the conventional conforming market data reported in this section exclude an estimate of B&C loans; the less-risky A-minus portion of the subprime market is included in the market definition. See section d below and Appendix D for a discussion of primary market definitions and the uncertainty surrounding estimates of the number of B&C loans in HMDA data. As noted there, B&C loans are much more

- Between 2001 and 2003, both Fannie Mae and Freddie Mac fell significantly below the market in funding affordable home purchase mortgage loans. During this period, special affordable loans accounted for 15.1 percent of Fannie Mae's purchases, 14.7 percent of Freddie Mac's purchases, and 16.2 percent of loans originated in the market; thus, the "Fannie-Mae-to-market" ratio was 0.93 and the "Freddie-Mac-to-market" ratio was also 0.91. During the same period, underserved area loans accounted for 24.7 percent of Fannie Mae's purchases, 23.1 percent of Freddie Mac's purchases, and 26.2 percent of loans originated in the market; the "Fannie-Mae-to-market" ratio was 0.94 and the "Freddie-Mac-to-market" ratio was only 0.88.

- While Freddie Mac has improved its affordable lending performance in the past two years, it has continued to lag the conventional conforming market in funding affordable home purchase loans for special affordable and low- and moderate-income borrowers and underserved neighborhoods targeted by the Housing Goals. In 2003, Freddie Mac's performance on the underserved areas goal was particularly low relative to both the performances of Fannie Mae and the market; in that year, underserved area loans accounted for only 24.0 percent of Freddie Mac's purchases compared with 26.8 percent of Fannie Mae's purchases and 27.6 percent of market originations.

- As noted above, Fannie Mae's average performance during past periods (*e.g.*, 1993–2003, 1996–2003, 1999–2003) has been below market levels. However, it is encouraging that Fannie Mae markedly improved its affordable lending performance relative to the market during 2001, 2002, and 2003, the first three years under the higher housing goal targets that HUD established in the GSE Final Rule dated October 2000. Over this three-year period, Fannie Mae led the primary market in funding special affordable and low- and moderate-income home purchase mortgage loans but lagged the market in funding underserved areas home purchase loans. In 2003, Fannie Mae's increased performance placed it significantly above the special affordable market (a 17.1 percent share for Fannie Mae compared with a 15.9 percent share for the market) and the low-mod market (a 47.0 percent share for Fannie Mae compared with a 44.6 percent share for the market). However, Fannie Mae continued to lag the

underserved areas market in 2003 (a 26.8 percent share for Fannie Mae compared with a 27.6 percent share for the market). These data are based on the "purchase year" approach, that is, Fannie Mae's performance is based on comparing its purchases of all home purchase loans (both seasoned loans and newly-originated mortgages) during a particular year with loans originated in the market in that year. When Fannie Mae's performance is measured on an "origination year" basis (that is, allocating Fannie Mae's purchases in a particular year to the year that the purchased loan was originated), Fannie Mae also led the 2003 market in funding special affordable and low- and moderate-income loans, and lagged the market in funding underserved area loans.

- Appendix A compares the GSEs' funding of first-time homebuyers with that of primary lenders in the conventional conforming market. Both Fannie Mae and Freddie Mac lag the market in funding first-time homebuyers, and by a rather wide margin. Between 1999 and 2002, first-time homebuyers accounted for 27 percent of each GSE's purchases of home purchase mortgages, compared with 38 percent for home purchase mortgages originated in the conventional conforming market. For minority first-time homebuyers, the GSE ratio was 6.2 percent, compared to a market originations ratio of 10.6 percent. For African-American and Hispanic first-time homebuyers, the GSE ratio was 3.8 percent, compared to a market originations ratio of 6.9 percent. For first-time homebuyers, particularly first-time minority homebuyers, both GSEs substantially lag the private conventional conforming market.

- The GSEs account for a small share of the market for important groups such as minority first-time homebuyers. Considering all mortgage originations (both government and conventional) between 1999 and 2001, it is estimated that the GSEs purchased only 14 percent of all loans originated for African-American and Hispanic first-time homebuyers, or one-third of their share (42 percent) of all home purchase loans originated during that period. Considering conventional conforming originations during the same time period, it is estimated that the GSEs purchased only 31 percent of loans for African-American and Hispanic first-time homebuyers, or about one-half of their share (57 percent) of all home purchase loans in that market. A large percentage of the lower-income loans purchased by the GSEs had relatively

low loan-to-value ratios and consequently high downpayments, which may explain the GSEs' limited role in the first-time homebuyer market.

Appendix A to this rule provides evidence that there is a significant population of potential homebuyers who are likely to respond well to increased homeownership opportunities produced by increased GSE purchases in this area. Immigrants and minorities, in particular, are expected to be a major source of future homebuyers.

#### d. Size of the Mortgage Market That Qualifies for the Housing Goals

The Department has estimated the size of the conventional, conforming market for loans that would qualify under each Housing Goal category based on 2000 Census data and geography. These estimates, which are changed slightly from estimates reported in the proposed rule, are as follows:

- 51–56 percent for the Low- and Moderate-Income Housing Goal
- 23–27 percent for the Special Affordable Housing Goal
- 35–39 percent for the Underserved Areas Housing Goal

These market estimates exclude the B&C (*i.e.*, subprime loans that are not A-minus grade) portion of the subprime market. The estimates, expressed as ranges, allow for economic and market affordability conditions that are more adverse than recent conditions. The market estimates are based on several mortgage market databases such as HMDA and American Housing Survey data. The Department's estimates of the size of the conventional mortgage market for each Housing Goal are discussed in detail in Appendix D to this rule.

The GSEs have room for growth in serving the affordable housing mortgage market. The Department estimates that the two GSEs' mortgage purchases accounted for 55 percent of the total (single-family and multifamily) conventional, conforming mortgage market between 1999 and 2002. In contrast, GSE purchases comprised 48 percent of the low- and moderate-income market, 48 percent of the underserved areas market, and a still smaller 41 percent of the special affordable market. Thus, the remaining 52–59 percent of the Goals-qualifying markets have not yet been touched by the GSEs.

The GSEs' presence in mortgage markets for rental properties, where much of the nation's affordable housing is concentrated, is below that in the single-family-owner market. The GSEs' share of the total rental market

(including both single-family and multifamily) was also less than 40 percent between 1999 and 2002. Obviously, there is room for the GSEs to

increase their presence in the single-family rental and multifamily rental markets.

Table 1 summarizes the Department's findings regarding GSE performance

relative to market projections for 2005–2008 and the Housing Goal levels for 2005–2008.

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**Table 1**  
**Market Estimates, Baseline Performance and 2005-2008 Housing Goals**

	2001-2004 Housing Goals	2005-2008 Housing Goals			GSEs' Average Baseline Performance 1999-2003 (Fannie Mae/ Freddie Mac) <sup>1</sup>		HUD's Projected Market Estimate <sup>2</sup>
		2005	2006	2007	2008		
Low- and Moderate-Income	50%	52%	53%	55%	56%	49% 47%	51-56%
Underserved Areas	31% <sup>3</sup>	37%	38%	38%	39%	35% 32%	35-39%
Special Affordable	20%	22%	23%	25%	27%	20% 19%	23-27%

<sup>1</sup> Baseline performance with 2005 assumptions, as shown in Tables 4, 6, and 8.

<sup>2</sup> See Appendix D for an explanation of the market estimates.

<sup>3</sup> Equivalent to 36% based on 2000 census tract geography, Metropolitan Statistical Areas as specified in 2003, and 2000 census data on area median income and minority concentrations.

The analysis for 2005 and later reflected in Table 1 is based on 2000 Census data on area median incomes and minority concentrations, using the metropolitan area boundaries specified by OMB in June 2003. This affects the market percentages for all three Housing Goals, as well as the figures on area median incomes and minority percentage figures that will be used to measure GSE performance on the Housing Goals beginning in 2005. The greatest effect of the updated data is on the Underserved Areas Housing Goal. Expressing this goal in terms of 2000 Census data adds approximately 5 percentage points to the Housing Goal and market levels, compared with analysis using 1990 Census data with Metropolitan Statistical Areas (MSAs) as defined prior to 2000.

The GSEs' baseline performance figures in Table 1 exclude the effects of the bonus points for small multifamily and single-family two-to-four unit owner-occupied properties and the Temporary Adjustment Factor (TAF) for Freddie Mac that were applied in official scoring toward the Housing Goals in 2001–2003. The Department did not extend these adjustments beyond 2003.

Table 1 reveals several features of HUD's Housing Goals. First, it is evident from this table that the 2005 level (22 percent) for the Special Affordable Housing Goal is below the low end (23 percent) of HUD's projected market range for 2005–2008. The 2005 level (52 percent) of the Low- and Moderate-

Income Housing Goal is slightly above the low-end (51 percent) of HUD's market estimate range.

Second, the 2005 Underserved Areas Housing Goal level (37 percent) is consistent with the market range (35–39 percent) now projected by HUD for the Housing Goals using 2000 Census data.

Third, the GSEs' performance on all of the Housing Goals was significantly below the market averages for 1999–2002. Appendix D to this rule provides market estimates for the years 1999–2002 under different assumptions about the multifamily mix (*i.e.*, newly-mortgaged multifamily units as a share of all financed dwelling units). The estimates differ between the two home purchase years (1999 and 2000) and the heavy refinance years (2001 and 2002). For the low-mod goal, the estimates average approximately 56 percent for the two home purchase years and 52 percent for the two heavy refinance years, with an overall 1999–2002 low-mod average of 54 percent (five percentage points above Fannie Mae's performance and seven percentage points above Freddie Mac's performance). The market estimates for the underserved areas goal average slightly over 37 percent (38 percent during the two home purchase years and 36 percent during the two heavy refinance years), or approximately 2–4 percentage points above the GSEs' performance (see Table 1). The higher Housing Goals are intended to move the GSEs closer to or within the market

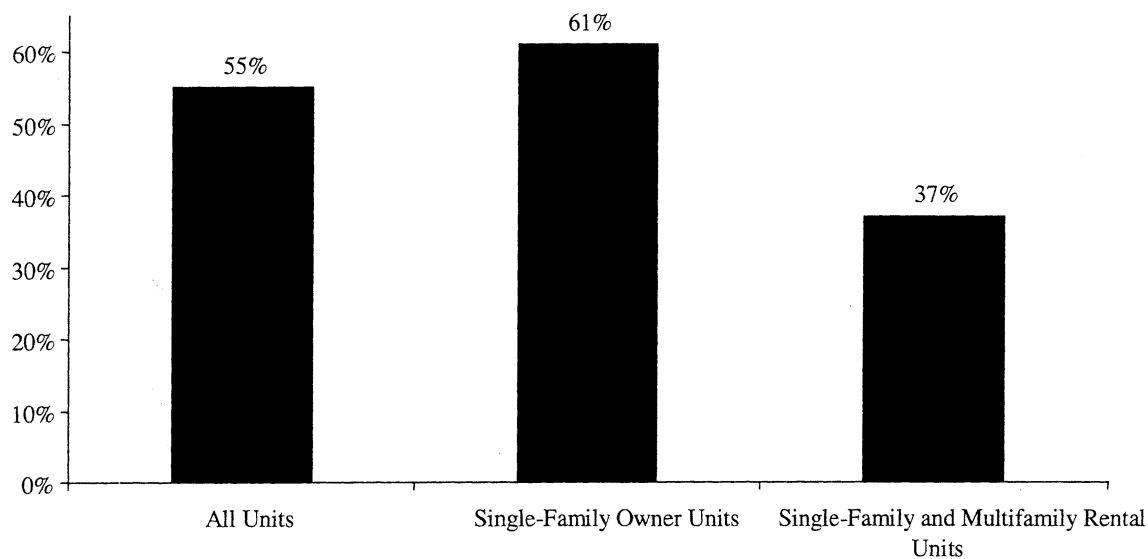
range for 2005, and to the upper end of the market range projection by 2008.

An analysis of the GSEs' mortgage purchases by property type shows that they have had much less presence in the “goals-rich” rental segments of the market, as compared with the “less-goals-rich” owner segment of the market. As shown in Figure 1, GSE mortgage purchases represented 37 percent of single-family and multifamily rental units financed between 1999 and 2002. This figure is much lower than their 61 percent market share for single-family owner-occupied properties. (Figure 2 provides unit-level detail comparing the GSEs' purchases with originations in the conventional conforming market.)

Typically, about 90 percent of rental units in single-family rental and multifamily properties qualify for the Low- and Moderate-Income Housing Goal, compared with about 44 percent of owner units. Corresponding figures for the Special Affordable Housing Goal are almost 60 percent of rental units and 16.4 percent of owner units. Thus, one reason that the GSEs' performance under the Low- and Moderate-Income Housing and Special Affordable Housing Goals has fallen short of HUD's market estimates is that the GSEs have had a relatively small presence in the two rental market segments, notwithstanding that these market segments are important sources of affordable housing and important components in HUD's market estimates.

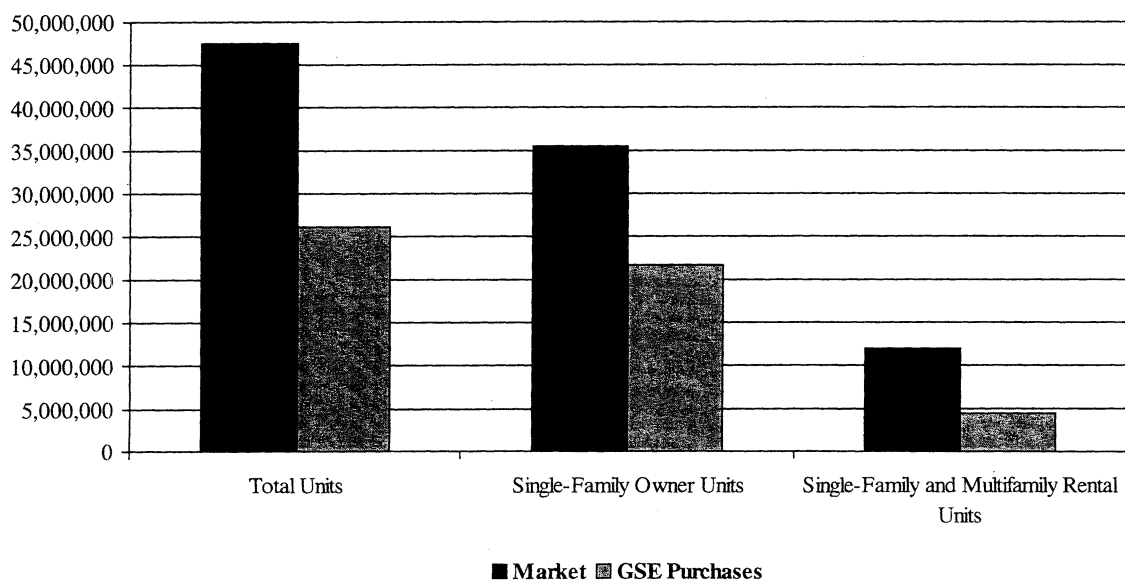
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**Figure 1**  
**GSEs' Share of the Conventional Conforming Market**  
**by Property Type, 1999-2002**



Source: See Table A.30, Appendix A.

**Figure 2**  
**Units in the Conventional Conforming Mortgage**  
**Market Compared to GSE Purchases**  
**by Property Type, 1999-2002**



Source: See Table A.30, Appendix A.

In the overall conventional conforming mortgage market, rental units in single-family properties and in multifamily properties represented approximately 25 percent of the overall mortgage market between 1999 and 2002, 42 percent of the units that collateralize mortgages qualifying for the Low- and Moderate-Income Housing Goal, and 56 percent of the units that collateralize mortgages qualifying for the Special Affordable Housing Goal. Yet between 1999 and 2002, units in such properties accounted for only 17 percent of the GSEs' overall purchases, 32 percent of the GSEs' purchases meeting the Low- and Moderate-Income Housing Goal, and 44 percent of the GSEs' purchases meeting the Special Affordable Housing Goal.<sup>8</sup> Continuing weakness in GSE purchases of mortgages on single-family rental and multifamily properties has been a significant factor underlying the shortfall between GSE performance and that of the primary mortgage market.

#### e. Ability of the GSEs To Lead the Industry

An important factor in determining the overall Housing Goal level is the ability of the GSEs to lead the industry in making mortgage credit available for Housing Goals—qualifying populations and areas.

The legislative history of FHEFSSA reflects Congress's strong concern that the GSEs need to do more to benefit low- and moderate-income families and residents of underserved areas that lack access to credit. (*See, e.g.*, S. Rep. No. 102-282, at 34.) The Senate Report on FHEFSSA emphasized that the GSEs should "lead the mortgage finance industry in making mortgage credit available for low- and moderate-income families." (*Id.*)

Thus, FHEFSSA specifically requires that HUD consider the ability of the GSEs to lead the industry in establishing the level of the Housing Goals. FHEFSSA also clarified the GSEs' responsibility to complement the requirements of the CRA (*see* section 1335(a)(3)(B) of FHEFSSA, 12 U.S.C. 4565(a)(3)(B)), and fair lending laws (*see* section 1325 of FHEFSSA, 12 U.S.C. 4545) in order to expand access to capital to those historically underserved by the housing finance market.

While leadership may be exhibited through the GSEs' introduction of innovative products, technology, and processes, and through their

establishment of partnerships and alliances with local communities and community groups, leadership must always involve increasing the availability of financing for homeownership and affordable rental housing. Thus, the GSEs' obligation to "lead the industry" entails leadership in facilitating access to affordable credit in the primary market for borrowers at different income levels, and with different housing needs, as well as in underserved urban and rural areas.

Because the GSEs' market presence varies significantly by property type, the Department examined whether the GSEs have led the industry in three different market sectors served by the GSEs: single-family-owner, single-family rental (those with at least one rental unit and no more than four units in total), and multifamily rental.

The GSEs' purchases between 1999 and 2002 financed almost 61 percent of the approximately 36 million owner-occupied units financed in the conventional conforming market during that period. The GSEs' state-of-the-art technology, staff resources, share of the total conventional conforming market, and financial strength strongly suggest that they have the ability to lead the industry in making home purchase credit available for low-income families and underserved neighborhoods. From the analysis in Appendices A-D to this rule, it is clear that the GSEs are able to improve their performance and lead the primary market in financing Housing Goals—qualifying home purchase mortgages. In fact, Fannie Mae's improved performance in 2003 is evidence of this potential, as it led the market in funding home purchase loans for special affordable and low- and moderate-income families.

As discussed in Appendix A to this rule, there are a wide variety of quantitative and qualitative indicators that demonstrate that the GSEs have ample, indeed robust, financial strength to improve their affordable lending performance. For example, the combined net income of the GSEs has risen steadily over the last 15 years, from \$888 million in 1988 to \$12.7 billion in 2003. This financial strength provides the GSEs with the resources to lead the industry in making mortgage financing available for families and neighborhoods targeted by the Housing Goals.<sup>9</sup>

<sup>9</sup> As discussed in Appendix D, the GSEs questioned HUD's historical estimates of the multifamily market as too high. Section C of Appendix D discusses these comments and responds. As indicated in Table A.30, multifamily loans accounted for 14.8 percent of all financed units in the market, excluding B&C loans. As

As noted above, the GSEs have been much less active in providing financing for the rental housing market. Between 1999 and 2002, the GSEs financed 4.5 million rental dwelling units, which represented 37 percent of the 12 million single-family and multifamily rental dwelling units that were financed in the conventional market during this period. Thus, the GSEs' share of the rental mortgage market was just three-fifths of their share of the market for mortgages on single-family owner-occupied properties.

Clearly there is room for the GSEs to increase their presence in the single-family rental and multifamily rental markets. As explained above, these markets are an important source of low- and moderate-income housing since these units qualify for the Housing Goals in a greater proportion than do single-family owner-occupied properties. Thus, Fannie Mae and Freddie Mac can improve their performance on each of the three Housing Goals if they increase their purchases of mortgages on rental properties.

As discussed below in Section II.C.4 of this preamble with respect to the Home Purchase Subgoals, both GSEs should be able to lead the market for single-family owner-occupied properties in all three housing goal categories—special affordable, low- and moderate-income, and underserved areas. The GSEs are already dominant players in this market, which, unlike the rental markets, is their main business activity. However, as already discussed, research studies conducted by HUD and academic researchers conclude that except for Fannie Mae's recent performance on the special affordable and low- and moderate-income categories, the GSEs have not led the primary market in financing owner-

reported in Section G of Appendix A and Sections F-H of Appendix D, HUD also conducted sensitivity analyses that reduced its 1999–2002 multifamily shares for the market by approximately two percentage points. As a result, 1999–2002 multifamily units decreased from 7,018,044 units to 5,991,036 units (reducing the multifamily share from 14.8 percent to 12.6 percent). With these reduced multifamily market numbers, the GSEs' share of the multifamily market increased from 35 percent to 41 percent. The GSEs also accounted for higher shares of the goals-qualifying multifamily market: 42 percent for low-mod units, 34 percent for underserved area units, and 37 percent for special affordable units. In this case, the GSEs' shares of the overall goals-qualifying markets (including single-family-owner, single-family-rental, and multifamily mortgages) increased as follows: low-mod—from 48 percent (*see* right column of Table A.30 in Appendix A) to 50 percent (*see* right column of Table A.31b in Appendix A); underserved areas—from 48 percent to 50 percent; and special affordable—from 41 percent to 43 percent.

<sup>8</sup> These percentage shares are computed from Table A.30 in Appendix A. Note that B&C loans are excluded from these data. *See* also Table A.31b in Appendix A.

occupied housing for low-income families, for first-time homebuyers, or for properties located in underserved areas.

As discussed above, the Housing Goals established by this rule are quantitative measures of how well the GSEs are serving low- and moderate-income homebuyers. HUD received comments on this factor from Freddie Mac and one other commenter. The commenter stated that, in addition to measuring leadership through the purchase of goal-qualifying mortgages, Fannie Mae and Freddie Mac's leadership should be measured in more qualitative ways such as their "development of products and technologies that the private sector may not be willing or able to do as well." This commenter asserted that through the qualitative leadership of the GSEs, homeownership opportunities are expanded and costs lowered for all potential purchasers, including those in more affordable markets.

With respect to the issue of leadership, Freddie Mac contended in its comments on the proposed rule that HUD misinterpreted the "leading the industry" statutory factor and asserted that "[t]here is no intimation in the Act or its legislative history that Congress intended industry leadership to be determined based on the enterprises purchases of goal-qualifying mortgages." Moreover, Freddie Mac commented that the GSEs are statutorily mandated to "facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes." Freddie Mac stated that the overall public purpose of the GSEs is to facilitate the operation of, and provide ongoing assistance to, the secondary market for residential mortgages. To the extent that the proposed goals inhibit or endanger Freddie Mac's ability to accomplish its general purpose of bringing liquidity and stability to the residential mortgage market, Freddie Mac contended that its ability to "lead the market" is in jeopardy. While the Department recognizes the degree of qualitative leadership provided by the GSEs, the Department also believes that their expertise and substantial financial resources allow them to lead quantitatively as well.

#### f. Need To Maintain the Sound Financial Condition of the GSEs

Based on HUD's economic analysis prepared for this final rule (Economic Analysis) and review by OFHEO, the Department has concluded that the Housing Goals in this final rule will not adversely affect the sound financial

condition of the GSEs. Further discussion of this issue is found in the Economic Analysis.

#### 3. Determinations Regarding the Levels of the Housing Goals

There are several reasons why the Department, having considered all the statutory factors as well as the comments on the May 3, 2004, proposed rule, is increasing the levels of the Housing Goals. The following sections describe these reasons and discuss and respond to comments received by HUD regarding the levels of the housing goals.

##### a. HUD's Market Analysis

*Summary of Comments and HUD's Determination.* As part of the process of establishing goals, HUD estimates the size of the conventional conforming mortgage market. In this process, HUD separately analyzes the markets for several different categories of mortgage loans: single-family owner-occupied housing units, rental units in two-to-four unit properties where the owner occupies one unit, rental units in one-to-four-unit investor-owned properties, and rental units in multifamily (five or more units) properties. This categorization is necessary because the data sources differ for the various categories, and it is also desirable because goals-qualifying shares of units vary markedly by category. HUD described its methodology for analyzing each category in Appendix D to the proposed rule, and the GSEs commented on that analysis. Other commenters expressed concern about the magnitude of the goals, but did not discuss the analysis on which the goals calculations were based.

##### (i) Multifamily Share of the Mortgage Market

An important component of HUD's calculation process is estimating the number of multifamily units financed each year as a percentage share of the total number of dwelling units financed (often referred to as the "multifamily mix"); this is important because of the high proportions of multifamily units, which qualify for credit under all three goals. Section C of Appendix D to this Final Rule provides a detailed discussion of estimates of the size of the multifamily mortgage market, including estimates by HUD, the GSEs, and other researchers. As explained in Appendix D, comprehensive data on the annual volume of multifamily mortgage originations are much less available than similar data on single-family mortgage originations. This introduces a degree of uncertainty into the market

sizing analysis and highlights the need for sensitivity analyses to show the effects of different multifamily mixes on the size of the goals-qualifying markets. As explained below, HUD's market analysis focused on multifamily mixes between 13.5 percent and 16.0 percent, with a baseline of 15 percent. This range and baseline is consistent with HUD's historical estimates of the multifamily mix reported in Table D.5b of Appendix D. For example, between 1995 and 2002, HUD estimated that the multifamily mix was in the 14–16 percent range.

In its comments, Fannie Mae estimated a multifamily mix of 12.3 percent, stating that HUD's range is too high for current conditions in the multifamily market. Fannie Mae cited the current high vacancy rates for multifamily properties and the fact that the population aged 20 to 34 will not begin to increase until after 2007; this age group tends to be predominantly renters. Fannie Mae also projected a low multifamily refinance volume, because of a recent peak in multifamily originations; these recent originations will not be able to refinance easily under their current contracts until 2008 or later.

At Freddie Mac's request, ICF Consulting also calculated the multifamily mix. In its best estimate, ICF projected an average of 14.2 percent over the 2005–2008 period, ranging between 13.7 percent and 14.7 percent in individual years, while recognizing that the actual outcomes may be higher or lower. ICF projected multifamily refinancings based on the number of units financed eight, nine, and ten years ago, because 10-year balloon mortgages are the most common multifamily mortgages, and prepayment possibilities are limited by yield maintenance agreements in their current mortgage contracts.

In Appendix D to this rule, HUD reviews the evidence provided by the GSEs in their comments. HUD notes that the 2001 Residential Finance Survey (RFS) has recently been published by the Census Bureau, and that the RFS provides higher estimates of the multifamily mix for 1999–2001 (the most recent years available) than either Fannie Mae or ICF. The RFS data and other data analyzed in Appendix D to this rule suggest that 15.0 percent is a reasonable baseline, particularly in a home purchase mortgage market environment, with a relatively small volume of refinanced mortgage originations. HUD also notes that the ICF average of 14.2 percent is fairly close to HUD's estimate of 15.0 percent. HUD therefore continues to use 15.0 percent as the best estimate of the

projected share of multifamily mortgages over the 2005–2008 period. HUD reports the goals-qualifying shares of mortgage originations on the basis of this estimate in Appendix D to this rule. HUD also publishes sensitivity analyses using other estimates of the multifamily mix, including 12.3 percent (Fannie Mae estimate), 13.5 percent (low end of HUD's range), 14.2 percent (ICF's best estimate), and 16.0 percent (high end of HUD's range). Using this range of multifamily mix estimates, the estimate of the goals-qualifying share of mortgage originations varies by about 1.5 to 2.5 percentage points for the low-mod goal, by about 1.0 percentage point for the underserved areas goal, and by about 1.2 to 1.7 percentage points for the special affordable housing goal. The estimate varies depending on other market factors.

As also discussed in Appendix D to this final rule, the multifamily mix is even lower during heavy refinance environments, as single-family owner refinance loans dominate both the market and the GSEs' purchases. This makes it more difficult for the GSEs to meet specific Housing Goal targets. As discussed in section b below of this preamble, HUD is soliciting public comments on how to structure and implement a regulatory provision to take account of the effects of high volumes of refinance loans in some years on the GSEs' ability to achieve the Housing Goals.

#### (ii) Single-Family Rental Share of the Mortgage Market

HUD also estimated the distribution of mortgage originations for single-family properties, defined as structures with one-to-four units. In Appendix D to this rule, HUD disaggregates single-family mortgage originations into three categories: those on owner-occupied single-family homes, those on structures with two to four units having one unit owner-occupied, and those on structures with one to four rental units owned by investors. HUD bases this categorization on the fact that the rental units in the latter two categories qualify at much higher rates for the housing goals.

HUD uses two data sources in Appendix D to estimate the size of the investor category, the Residential Finance Survey (RFS) and the Home Mortgage Disclosure Act database (HMDA). HMDA provides data only on the investor category. The investor share of HMDA single-family loans averaged 7.8 percent over 1993–2003, and 8.3 percent over the recent period of 1999–2003. The share of investor loans has also been rising for home purchase

loans; it was 9.6 percent over 1993–2003 and 11.2 percent over 1999–2003. The RFS for 2001 reported a larger share of investor loans than HMDA, 13.4 percent compared to 7.8 percent. The RFS also reported larger investor shares for 1999 and 2000.

In the proposed rule, HUD estimated the investor share of the single-family market at 10 percent, based on HMDA data and the 2001 RFS, which was then the most recent available. HUD also considered alternatives of 8 percent and 12 percent. Both GSEs and ICF commented that HUD should use HMDA data rather than RFS data, and should use a lower investor share in setting the goals. While they agreed with HUD that the RFS provides the most accurate estimate of the true investor share of the market, they stated that lender reporting of investor loans to the GSEs is conceptually closer to HMDA data, which are based on lender reports. They commented that the actual opportunities available to the GSEs in the single-family investor loan market are best measured by data that lenders report, based on actual loan applications.

Fannie Mae stated that HUD's two highest alternatives exceed the highest investor share ever reported in HMDA. Fannie Mae cited research indicating a reporting bias in HMDA, due to "hidden investors." At the time of loan origination, a property may be owner-occupied or intended for owner-occupancy, but may become rental shortly after origination. Fannie Mae stated that the same bias exists in its own reporting. The hidden investors cannot be identified at the time of origination.

Freddie Mac stated that investors have an incentive to claim falsely that they are owner-occupants because investor properties are subject to higher underwriting standards and loans tend to carry higher interest rates. Freddie Mac concluded that HUD should measure the opportunities that are actually available in the market to the GSEs, which are best measured by lender-reported HMDA data.

In this rule, HUD has adopted HMDA data as the basis for its calculation of the investor share of single-family mortgage originations. The GSEs make a valid argument that lender-reported data at the time of origination measures the investor loans that are available for them to purchase; HMDA provides that data. As discussed in Appendix D to this rule, HUD projects the investor share to be 8.5 to 9.0 percent (based on HMDA) during the 2005–2008 home purchase environments, rather than 10 percent. HUD also reports sensitivity

analyses for higher and lower investor shares of 8.0 and 9.5 percent. Using this range of single-family investor share estimates, the estimate of the goals-qualifying share of mortgage originations varies by about 1.5 percentage points for the low-mod goal, and by 0.5 percent or less for the other two goals. The estimate varies depending on other market factors.

In the proposed rule, HUD estimated that the share of the single-family market consisting of two-to-four units properties with one unit owner-occupied was 2.0 percent of all single-family mortgages. This category is reported only in the RFS. The 2001 RFS reports that this category comprised 1.5 percent of all single-family mortgages. Because the RFS calculates a higher share of investor mortgages in the single-family market (13.4 percent) than HUD employs in this rule (8.5 to 9.0 percent), it is necessary to adjust the 2001 RFS figure upward.

The RFS reports that 85.1 percent of all single-family mortgages were for owner-occupied homes. The estimated share of two-to-four units properties with one unit owner-occupied in the single-family market is calculated at 1.73 percent (*i.e.*, 1.5 percent/[1.5 percent + 85.1 percent]). This figure lies between Fannie Mae's share of about 2.0 percent over 1999–2003 and Freddie Mac's share of about 1.5 percent. In this final rule, HUD uses a share of 1.6 percent. Sensitivity analyses for 2.0 percent are reported in Appendix D to this rule.

Similarly, the single-family owner-occupied share is adjusted upward to take account of the lower share of investor loans, from 85.1 percent to 89.9 percent.

The estimated market share range for each of the three goals categories is as follows: 51–56 percent for the Low- and Moderate-Income Goal, 35–39 percent for the Underserved Areas Goal, and 23–27 percent for the Special Affordable Goal. These estimates are one percentage point below the market ranges reported in the Proposed Rule, for the reasons discussed above and detailed in Sections F–H of Appendix D. The top ends of the market ranges were reduced as follows: from 57 percent to 56 percent for the low- and moderate-income market; from 40 percent to 39 percent for the underserved areas market; and from 28 percent to 27 percent for the special affordable market. Accordingly, the 2008 goals were also reduced by one percentage point from those included in the Proposed Rule. In the Final Rule, the Low- and Moderate-Income Goal increases from 52 percent in 2005 to 56 percent in 2008, as

compared with an increase of 52 percent to 57 percent in the Proposed Rule. In the Final Rule, the Underserved Areas Goal increases from 37 percent in 2005 to 39 percent in 2008, as compared with an increase of 38 percent to 40 percent in the Proposed Rule. In the Final Rule, the Special Affordable Goal increases from 22 percent in 2005 to 27 percent in 2008, as compared with an increase of 22 percent to 28 percent in the Proposed Rule.

#### b. Attainability of the Goals in a High Refinance Environment

*Summary of Comments.* A common theme of many of the public comments was concern about the volatility of the mortgage market and how such volatility makes setting Housing Goals a delicate and risky proposition.

These commenters indicated that the goals proposed by HUD would be unattainable, particularly in a high refinance environment when a large portion of the mortgage market is comprised of refinance loans rather than home purchase mortgages.

Fannie Mae and others suggested that including single-family refinance mortgages in goals calculations creates tension between liquidity goals and affordable housing goals by taking the emphasis away from increasing purchase money mortgages (and therefore homeownership) and placing the focus instead on meeting high goals.

Freddie Mac, several trade associations, a financial organization and consumer advocacy groups also expressed concern that inclusion of single-family refinances jeopardizes the GSEs' abilities to increase homeownership through acquisitions of purchase money mortgages because the focus would be on attaining goals rather than providing affordable home purchases for the target population.

One trade association, however, asserted that removing refinance mortgages from the goals calculations would only serve to encourage the GSEs to buy refinance loans instead of home purchase loans. By buying refinance loans, the GSEs could effectively ignore housing goals and both "jeopardize the safety and soundness of the GSEs due to the higher default rate of refinance loans and increase the minority housing gap due to the lower rate of minority borrowers for refinance loans."

Other commenters suggested that the final rule should include mechanisms for making adjustments to the goals if there are changes in market conditions including a surge or drop in refinance volume. These commenters asserted that the GSEs' ability to successfully meet the goals should not be contingent upon

interest rate stability. One suggestion that was offered for dealing with market mix fluctuations (*i.e.*, between home purchase and refinance loans) was to remove from both the numerator and denominator "any mortgage activity in excess of the percentage of home refinance loans used by HUD for estimating the size of this market (*i.e.*, above 35%)."

Another commenter stated that "HUD should simply set goals that require the GSEs to lead the market, whatever the market turns out to be." This commenter explained that "if 50% of home purchase loans are to low-moderate income borrowers in 2005, then HUD should expect that a slightly higher percentage than this, say 51%, of Fannie's and Freddie's home purchase loans should fit in the purchase category of loans to low-moderate income borrowers."

*HUD's Determination.* This final rule retains the approach of the May 3, 2004, proposed rule, in which the level of each Housing Goal will increase year-by-year so that by 2008 each goal will match the top of the market range established in section 2.d, above.

The last three years have shown unprecedented volumes of refinance activity. For both GSEs, refinance loans accounted for 64 percent of all loans on single-family owner-occupied properties in 2001.<sup>10</sup> The refinance shares increased to 70 percent for Fannie Mae and 73 percent for Freddie Mac in 2002, and rose even further last year, to 79 percent for Fannie Mae and 82 percent for Freddie Mac. These unexpected record refinance rates made it more challenging for the GSEs to attain the housing goals in the past few years, as discussed elsewhere in this Preamble. The goals in HUD's proposed rule for the latter part of the 2005–2008 period would be even more challenging if (contrary to current expectations) very high refinance rates are experienced in those years.

HUD received a number of public comments seeking a regulatory solution to the issue of the ability of the GSEs to meet the housing goals during a period when refinances of home mortgages constitute an unusually large share of the mortgage market. HUD is not addressing the refinance issue as a regulatory change in this final rule. Elsewhere in today's **Federal Register**, HUD is publishing an Advance Notice of Proposed Rulemaking that advises the public of HUD's intention to consider by separate rulemaking a provision that

<sup>10</sup> By way of comparison, the refinance rate was 29 percent for both Fannie Mae and Freddie Mac in 2000.

recognizes and takes into consideration the impact of high volumes of refinance transactions on the GSEs' ability to achieve the housing goals in certain years, and solicits proposals on how such a provision should be structured and implemented. HUD believes that it would benefit from further consideration and additional public input on this issue. HUD also notes that FHEFSSA provides a mechanism by which HUD can take into consideration market and economic conditions that may make the achievement of housing goals infeasible in a given year. (See 12 U.S.C. 4566(b).)

#### c. Bonus Points

The Housing Goals 2000 final rule provided for the award of bonus points (double credit) toward the Housing Goals for both GSEs' mortgage purchases that financed single-family, owner-occupied two-to-four unit properties and 5–50 unit multifamily properties. The rule also established a temporary adjustment factor (TAF) that awarded Freddie Mac 1.2 units credit for each multifamily unit in properties over 50 units for calendar years 2001 through 2003. (Congress increased the level of the TAF to 1.35 per unit under section 1002 of Public Law 106–554.)

The Housing Goals 2000 final rule made clear that both of these measures were temporary, intended to encourage the GSEs to increase their efforts to meet financing needs that had not been well served. During the three years for which the temporary bonus points and TAF were established, HUD expected the GSEs to develop new, sustainable business relationships and purchasing strategies for the targeted needs. Data indicate that, because both GSEs did increase their financing of units targeted by the bonus points and the TAF, the original objectives were met. The Department determined at the end of the three years (2001–2003) not to extend the bonus points or the TAF.

*Summary of Comments.* A number of non-GSE commenters, including organizations representing affordable housing and consumer groups, trade associations, organizations representing racial and ethnic minorities, other organizations, and both Fannie Mae and Freddie Mac, recommended that the Department reinstate the award of bonus points for the GSEs which were established for 2001–2003 but which the Department did not continue after the end of 2003. Various non-GSE commenters, in addition to recommending reinstatement, also suggested that HUD develop new bonus point incentives for other unmet housing needs, such as manufactured

housing, rural housing, or tax credit properties or for particular groups, *e.g.*, Native Americans, other minority populations, or persons with disabilities.

Fannie Mae recommended that HUD provide bonuses for targeted business such as extremely low-income households, *i.e.*, those with incomes less than 30% of area median income (AMI); first-time homebuyers; manufactured housing; rural areas; and small multifamily properties. Freddie Mac suggested that instead of purchase money subgoals, the Department could provide bonus point incentives for these mortgages. Freddie Mac stated that the bonus points for two-to-four unit and 5–50 unit properties provided an extremely effective incentive. Freddie Mac indicated that other markets that could be assisted by bonus points are rural and manufactured housing. Freddie Mac noted that the Department's concern that bonus points obfuscate the GSEs' actual goals-qualifying performance is easily remedied by having the GSEs report two numbers, one with and one without the bonuses.

*HUD's Determination.* The Department has fully considered the comments suggesting the re-introduction of bonus points, as well as other types of targeted incentives for the GSEs' mortgage purchases, and has determined not to reinstate the bonus points for the years covered by this rule. The position of the Department discussed in the preamble of the proposed rule (*see* 69 FR 24228, 24232) remains unchanged; that is, the continued use of the bonus points "would only result in misleading information about the extent to which the GSEs are, in fact, meeting the Housing Goals." In addition, the Department reiterates that the "decision to increase the levels of the Housing Goals substantially in a staged manner \* \* \* and, at the same time, not renew the bonus points or TAF, will ensure that the GSEs continue to address the areas formerly targeted by these measures" (*see* 69 FR 24228, 24232).

#### d. Appropriate Levels of the Goals

In the May 3, 2004, proposed rule, HUD set the Goals to increase to levels at or near the high end of the estimated market range for each goal category by 2008. A large number of commenters expressed concern that these goal levels were set too high, and could have deleterious consequences for the mortgage market as a whole, or for specific sectors of the market.

Fannie Mae commented that a high allocation of affordable mortgage credit

will take away from the broad middle class, especially in high-housing cost regions. For example, Fannie Mae asserted that if the special affordable housing goal had been set at 28 percent in 2003, then it would have needed to greatly curtail support to the overall market to meet that goal. Fannie Mae concluded that such manipulation does not promote stability and limits liquidity, and that it can shut out working middle class borrowers, contribute to higher interest rates and lower conforming loan limits.

Many commenters, including Freddie Mac, also claimed that setting the goals at a high percentage may lead to denominator management. They state that denominator management would occur if a GSE purposely abstained from buying mortgages in the markets that are not goals-eligible, rather than increasing its purchases in markets that are goals-eligible. Freddie Mac contended that this may be necessary if goals are set above the market percentage of available goal-qualifying loans. One financial institution observed that denominator management "will be exacerbated by the fact that the GSEs do not operate in the primary market and do not have any direct control over the origination strategies of their customers."

In addition to the allocation problems discussed above, the GSEs stated that the liquidity requirements in their charters imply that they must stand ready to buy any and all conventional, conforming residential mortgages. They contend that denominator management is in direct conflict with these provisions, and goals set higher than market originations could force the GSEs to refuse to purchase mortgages that are not eligible. This, in turn, could reduce liquidity in the market. Knowing that the GSEs would no longer stand willing and able to purchase all conventional, conforming mortgages, other market participants might be less willing to hold these mortgages in their portfolios, and general liquidity would decline. The GSEs further asserted that changing market forces could cause swings in prices and trading volumes, and these temporary disturbances could create unstable markets, increase risk, and reduce the willingness of investors to invest in the sector. Thus, the GSEs maintained that denominator management decreases market stability.

The GSEs pointed to specific historical examples that describe their positive influence on stability. They maintained that during the 1990–1991 recession, the GSEs advised that they stood ready to purchase mortgages while many industry participants curtailed their purchase programs.

Using historical trends in prices, the GSEs asserted that their presence in the mortgage market explains why mortgage-backed securities have a more stable price trend than commodity markets. They warned that because of denominator management resulting from unrealistic goals, they could not buy mortgage-backed securities and encourage stability in a financial crisis.

The GSEs further contended that if they reduce their willingness to buy non-goals eligible mortgages, it will be harder for borrowers whose incomes marginally exceed goals eligibility requirements to obtain financing since the two income-based Housing Goals compare the incomes of the borrower or resident to area median income. For example, the combined incomes in a working family may just disqualify that family's loan for eligibility under the low- and moderate-income goal even though each individual's income would not be considered to be affluent. The GSEs and other commenters provided examples of working families in the middle class, such as "teacher/fireman" households, that could encounter difficulties in financing a home.

Moreover, the commenters asserted that non-goal qualifying households may have higher costs associated with available financing since these mortgages would be less likely to be purchased by a GSE. Freddie Mac asserted that HUD did not take this into account in its cost/benefit analysis.

Furthermore, commenters claimed that denominator management may contribute to higher interest rates and, as a result, harm the precise borrowers that HUD is trying to help. These commenters stated that if denominator management reduces liquidity then the supply of mortgage funds will decline and interest rates will rise. The GSEs contended that if they are less willing to buy mortgages under all conditions, then investors will be less willing to provide funds to the market. As a result, the GSEs claimed that as investors seek out safer instruments, home mortgage interest rates will rise, and this rise in home mortgage rates will harm even those borrowers that are still goals-eligible.

Several commenters expressed concern about the effect of the goals on high cost markets. One commenter explained that while the goals are set with a national standard, a market level analysis "reveals a pronounced shortage of affordable mortgages in high cost housing markets." Commenters stated that the GSEs' current loan purchasing patterns demonstrate that market affordability already has an impact on goals-related purchases. The

commenters expressed concern that high cost markets could see even tighter credit if the proposed goals are enacted.

The GSEs note that under HUD's May 3, 2004, proposed rule, the goal levels rise to levels at the top of HUD's market range in 2008 and stabilize there. They state that the projected market range concept is one in which HUD projects market levels of loans generated within each goal category will fluctuate within the range, depending on relative volumes of single-family refinance loans relative to other loans, interest rates and other macroeconomic and housing market conditions. The GSEs express the concern that, in any particular year, they could be confronted with goal levels that are several percentage points higher than the market percentages of goal-qualifying loans, or goal levels that are at the market percentages. The GSEs state that if HUD's proposed Housing Goals are retained, they foresee years when the goal levels will be attainable only by means of "denominator management" in which they limit their purchases of loans that do not qualify for the goals.

*HUD's Determination.* Many of the comments expressed concern about the goal levels established for the last year or two of the period covered by this rule. In these years, the goals are set at the market levels estimated by HUD. Also, since they are the later years, market projections are necessarily more imprecise. In particular, the possibility of a decline in mortgage interest rates in those years raises the possibility of another boom in refinancing, and thus greater difficulty for the GSEs to meet the housing goals without denominator management. The comments relating to middle-income borrowers are predicated on the difficulty of foreseeing refinance volatility. Recent years have seen large unexpected home refinance rates. Since higher income homeowners disproportionately engage in refinancing, inclusion of refinance loans in the denominator increases the difficulty of GSE goals performance. A middle-income borrower just above the low/mod bracket would be less attractive to the GSEs in high refinance years. As noted in section II.C.3.b., HUD is considering in a separate rulemaking a provision that recognizes and takes into consideration the impact of high volumes of refinance transactions on the GSEs' ability to achieve the housing goals in certain years. HUD also notes that FHEFSSA provides a mechanism by which HUD can take into consideration market and economic conditions that may make the achievement of housing goals infeasible in a given year. (See 12 U.S.C. 4566(b).)

With regard to the effects of the goals on high-cost markets, HUD notes that the overall presence of the GSEs in these markets depends on the conforming loan limit, which has been established by Congress for all states, including states deemed to be "high-cost areas." With regard to HUD's housing goals more specifically, the low- and moderate-income and special affordable goals are based on borrower income relative to area median income, thus a mortgage for a lower-income family in a high-income metropolitan area will count towards the goals in the same manner as a mortgage for a lower-income family in a low-income area. Underserved areas are defined in terms of median family income in a census tract relative for median income in the area; thus a mortgage for a family living in a lower-income tract in a high-income metropolitan area will count towards the goals in the same manner as a mortgage for a family living in a lower-income tract in a low-income area. Thus HUD concludes that its housing goals will have no adverse impact on borrowers or neighborhoods in areas with high housing costs.

#### e. Consequences of the Goals for FHA

Fannie Mae, Freddie Mac, several trade associations, two advocacy groups and two financial institutions expressed concern over the impact HUD's proposed goals would have on the future solvency of the FHA program. One trade association asserted that "excessive goals will push GSEs to expand into the least-risky part of the FHA market and put into question FHA's long-term viability."

The aforementioned commenters reiterated this point by stating that unrealistically high goals would compel the GSEs to increase competition with FHA for higher credit quality borrowers and would therefore further undermine the FHA program in the long-run. One advocacy group asserted that not only will these goals encourage the GSEs to compete with FHA more in the single family sector but in the multifamily sector as well.

Freddie Mac and Fannie Mae agreed that they would be compelled to more aggressively compete with FHA in procuring top-quality borrowers. Freddie Mac stated that the GSEs would take as many as "1/3 of all FHA borrowers." Freddie Mac and two trade associations further contended that such a loss to the FHA program would be seen in the increasing expenses to the remaining FHA borrowers. As the FHA program loses better quality loans to the GSEs, the result would be "higher fees to FHA borrowers or government

subsidies to pay claims, effectively making FHA the lender of last resort," said one trade association.

One financial institution stated that the so-called competition for goals-qualifying loans would not be between traditional conventional lenders vying for loans with a separate group of traditional FHA lenders, but rather an acceleration of product competition within a single group of existing lenders who originate for both markets. This commenter stated that 12 of the top 15 (by volume) FHA/VA lenders are also among the top 15 conventional lenders and indicated that the increased product competition would not result in a net increase in goals-qualifying loans, but in a shift from FHA to the GSEs of FHA's relatively lower risks.

*HUD's Determination.* The Department agrees with many of these commenters that improvements in technology, such as the widespread use of commercial credit scores, mortgage scores, and automated underwriting systems, have fundamentally changed the way lenders process loan applications in recent years. Where once rules-based underwriting distinctions between prime conventional and FHA loans were fairly clear, in recent years, with the new technology, these distinctions have become blurred. For example, loan applications with payment-to-income ratios above conventional market guidelines were once clearly candidates for FHA financing because FHA would accept applicants with higher payment-to-income ratios. However, today, the same application would be processed using an automated underwriting system (AUS) that scores the application based on the totality of the application's risk factors. What once may have been an unacceptable payment-to-income ratio for a prime conventional loan may now be acceptable if the application contains offsetting low risks in other key areas such as borrower cash reserves, loan-to-value ratio, or commercial credit scores.

In addition to these technological changes, FHA made several changes to its underwriting guidelines in FY 1995 in order to promote increased homeownership opportunities among low-income and minority homebuyers. By doing so, FHA modestly increased the risk characteristics of its post-1995 books of business, but it succeeded in raising FHA's proportion of first-time homebuyers from 60.9 percent in fiscal year 1994 to 73.0 percent in fiscal year 2003. During the same period (fiscal years 1994 to 2003), FHA's proportion of minority borrowers increased from 24.8 percent to 33.0 percent, and has since remained at this level, or higher.

The new technology may allow the conventional market to identify lower risk loan applications that historically have come to FHA. However, the ability to identify risks does not, in and of itself, equate to shifts in market share from FHA to conventional lenders. Better pricing for borrowers by the conventional market is required to lure lower risk borrowers from FHA. If conventional lenders use the new technology to not only evaluate risks but also to price according to risk, then there may be some shift from FHA to the conventional market. Such a shift can produce tangible benefits for borrowers in the form of lower cost mortgage financing.

The Department does not believe it is FHA's mission to compete with the private sector. Rather, FHA's mission is to complement the conventional market, using FHA's cost of capital advantage where it can have the most benefit in creating homeownership opportunities for those households who might not otherwise be served by the prime conventional market.

HUD gauges the soundness of FHA's insurance funds in several ways. The statutorily mandated annual independent actuarial review of FHA's principal single-family insurance fund, the Mutual Mortgage Insurance Fund (MMIF), provides the Department, and the public, with an outside expert's estimate of the capital ratio of the overall fund, and the economic value of new business coming into the fund. The capital ratio indicates whether the existing books of business (current portfolio) are financially sound, while the economic value estimates of new business show whether if the marginal impact of new loans insured is adding or detracting from the financial health of the fund.<sup>11</sup> Specifically, the Fiscal Year 2003 actuarial review estimated the economic value of the MMIF at the end of Fiscal Year 2003 to be \$22.7 billion and the fund's capital ratio to be 5.21 percent—the eighth full year this ratio has exceeded the Congressionally mandated minimum of 2.0 percent. The economic value of new loans endorsed for insurance during 2003 was estimated by FHA's independent actuary to be \$2.8 billion, indicating new business coming into FHA is further contributing to FHA's reserves.

In comparison, the Fiscal Year 2002 actuarial review estimated the economic value and capital ratio of the MMIF at \$22.6 billion and 4.52 percent,

respectively. The increases in both measures for Fiscal Year 2003 were driven by the large positive economic value the actuary placed on a record dollar volume of new loans FHA insured in FY 2003 along with the rapid prepayment of older loans, keeping the end-of-year insurance-in-force (denominator of the capital ratio) down.

With regard to the GSEs taking multifamily business away from FHA, the Department notes that there are many differences between the types of multifamily mortgages FHA insures and those the GSEs purchase. For newly constructed multifamily properties, FHA insures the loan from the start of construction while GSE multifamily loan products generally do not. The GSEs do have forward commitment programs that can be used for new construction, but the purchase of the permanent loan by the GSEs generally requires the property to achieve minimum sustained occupancy levels, whereas FHA does not have this requirement. However, it is possible that the new goals will provide incentives for the GSEs to expand and refine their forward commitment products to be more attractive in the market for new multifamily housing. This could be a benefit to the market.

The greatest potential impact of the higher housing goals on FHA's multifamily business may come from a reduction in two of FHA's programs that address the purchase or refinance of existing properties. The first is the Section 223(f) program, which insures mortgages for the purchase or refinance of existing (over three year old) properties that are not currently financed with an FHA mortgage. This program accounted for about \$0.8 billion in endorsements for FHA during Fiscal Year 2003, and is expected to produce about \$0.5 billion in endorsements during Fiscal Year 2004. FHA's 223(f) business is estimated to be profitable to FHA—it is estimated to have a credit subsidy (net present value of all cash flows from the insurance contract at the time of endorsement) of negative 3.0%.<sup>12</sup> The second is the Section 223(a)(7) program, which insures mortgages for FHA-to-FHA refinances—that is, the refinance of an existing FHA-insured mortgage. Section 223(a)(7) is used, for example, to refinance loans previously insured under FHA's most used programs—i.e., Section 221(d)(4) new construction/

substantial rehabilitation, and Section 223(f). FHA endorsed over \$2.1 billion in Section 223(a)(7) loans during Fiscal Year 2003, and is expected to endorse about \$1.4 billion during Fiscal Year 2004. As with the Section 223(f) program, FHA's Section 223(a)(7) program is also profitable to FHA—operating with an estimated negative credit subsidy of 2.2%.

If FHA does lose some multifamily market share from its purchase or refinance programs for existing housing as a result of the goals, it would not likely have any significant impact on FHA overall.

#### f. Consequences of the Goals for the Multifamily Market

*Summary of Comments.* Several organizations commented on potential adverse consequences if the housing goals are set too high. Fannie Mae and Freddie Mac, among others, cited the recent high vacancy rates for multifamily rental housing as an example that increased lending by the GSEs at this time would encourage overbuilding.

Others stated that the multifamily market is already flush with capital and that inappropriate goals could promote overly aggressive bidding for loans and reckless lending.

One trade association stated that the increased presence of the two GSEs would promote a duopsony (a market with only two buyers) that would hinder competition in the multifamily mortgage market.

Other commenters suggested that increased loan purchases by the GSEs would skim the highest credit-quality loan from other mortgage lenders, and reduce the credit quality of multifamily loans remaining in the portfolios of pension funds or insured through FHA.

Another commenter stated that increased goals pressure on the GSEs would cause them to concentrate on large properties, where a single loan would contribute more toward goal attainment.

*HUD's Determination.* One of HUD's objectives in promulgating this final rule is to promote the availability of mortgage credit to affordable properties at the lowest possible cost. It is not the intent of this rule to promote the maximum flow of credit to this market, regardless of housing and mortgage market conditions.

Increased competition for business, as intended by the rule, should bring benefits to borrowers, and therefore renters, through lower interest rates and more attractive non-price terms. Such increased competition does not imply impaired credit quality or lax

<sup>11</sup> "Economic value" is the net present value of the fund's reserves plus expected future cash flows, and the "capital ratio" is economic value divided by insurance-in-force.

<sup>12</sup> A negative credit subsidy of 3.0 percent means that the net present value of FHA's revenues (premiums, fees, recoveries from claims paid, etc.) will exceed the net present value of FHA's program costs (claims and related expenses) by 3.0 percent of the total insured mortgage amount.

underwriting. As the GSEs compete more aggressively for multifamily business and gain market share, the market will not necessarily grow one-for-one with every additional loan purchased by the GSEs. It is likely that the market impacts will be more on the pricing of multifamily credit and less on the volume of credit supplied. Lower pricing of credit in and of itself does not promote overbuilding; its one unambiguous effect is to reduce the cost of supplying housing to consumers.

Demand for multifamily mortgages will be responsive to cyclical macroeconomic factors. Beyond these influences, demand for multifamily housing will be supported by favorable demographics. In its comments on the proposed rule, Fannie Mae highlighted the prospective growth in the number of people ages 20 through 34 in arguing that the demographics do not become clearly favorable to rental demand until late in this decade. But fewer than half of all renter households are headed by someone of this age, and more comprehensive estimates and projections suggest a steadier path of moderate growth in the demographic component of demand for multifamily housing.

Interest rates clearly will be important for the future path of mortgage lending, as noted by Fannie Mae, Freddie Mac, and other commenters. The historically low interest rates of recent years have spurred lending in both the multifamily and single-family markets. If interest rates should rise in the future, the volume of mortgage lending presumably would be lower than if rates were to remain at current levels. But the effect of higher rates on the GSEs' ability to achieve the housing goals is less clear. Because the goals are established in terms of shares of the GSEs' business, rather than levels, a key question is how higher interest rates would affect the relative demand for single-family and multifamily mortgage credit. Because of differences in prepayment provisions and other characteristics between single-family and multifamily mortgage lending, multifamily credit demand might drop off proportionally less than would single-family credit demand in response to higher rates.<sup>13</sup> This in turn would make it easier to attain the goal levels if interest rates were to increase from current levels.

<sup>13</sup> This is suggested by recent experience of below-average multifamily mix in years where the volume of single-family refinancings has been high. Further support is provided by evidence of a relationship between interest rates and the multifamily share of the net change in residential mortgage debt between 1975 and 2002.

Regarding the market structure implications of increased GSE multifamily activity, HUD estimates that the GSEs purchased slightly less than one-third of the dollar volume of conventional multifamily loan originations during 2001–2003 (see Table D.2). There is room for increasing this market share without producing the duopoly alluded to in the previously cited comments. Furthermore, if the GSEs do increase their market penetration, it is because they are offering multifamily borrowers more attractive products or pricing than are their competitors, including the pension funds and FHA programs alluded to by some commenting organizations. The borrower and, ultimately, the rent-paying affordable housing resident benefit from these more attractive products and pricing.

In summary, the Department's determination is that the Housing Goal levels established by this rule are prudent and will improve the availability and pricing of credit for affordable multifamily properties. For the reasons stated above, it is the Department's view that the rule will not have the adverse consequences mentioned in some comments on the proposed rule.

#### g. Consequences of the Goals for the Single-Family Rental Market

*Summary of Comments.* Several community organizations raised concerns about encouraging the single-family rental market. They asserted that the goals should target families who want to live in the financed houses, as opposed to the investors who purchase these homes. In these commenters' view, investors take affordable housing stock off the market, which raises the price for low and moderate-income first-time homebuyers. They claimed that homeownership should be stressed because home equity is a large component of the disparity that exists in household net wealth between ethnic groups.

Some commenters cited studies that suggest homeownership has beneficial neighborhood effects relative to investor-owned properties. According to one cited study, absentee landlords are much more likely to let housing stock decline but homeowners are much more likely to invest in the upkeep of their homes. In the view of one of these organizations, the incentives that the GSEs receive for rental housing should be to promote multifamily developments, not single-family homes.

*HUD's Determination.* HUD considered many factors related to the single-family rental market. Single-

family rentals are another source of affordable housing. Also, the capital provided by investors can help maintain demand for single-family homes in underserved neighborhoods. While some commenters complained that this raises the cost to first-time homebuyers, investors also help to maintain the liquidity and value of owner-occupied homes. Further, there are some investors who make it their business to renovate the housing stock and resell the properties. On balance, HUD found no compelling evidence that single-family rentals should be excluded from goals eligibility.

#### h. Consequences of the Goals for the Subprime Market

*Summary of Comments.* Both GSEs indicated that they would need to increase their purchase of subprime loans to meet the higher goals. Freddie Mac stated that the increased affordable housing goals created tension in its business practices between meeting the goals and conducting responsible lending practices.

In the past, Fannie Mae and Freddie Mac have voluntarily decided not to purchase subprime loans with features such as single-premium life insurance and prepayment penalty terms that exceed three years, or to purchase loans subject to the Home Ownership and Equity Protection Act (HOEPA). Freddie Mac indicated that the increased goals would limit its ability to influence subprime lending practices. More specifically, Freddie Mac claimed that, to meet the higher housing goals, it might not have the option in the future of turning away subprime loans that have less desirable loan terms than the subprime business it currently purchases.

Several commenters suggested that if the GSEs are pushed to serve more of the subprime market, they will skim a significant portion of the lower-risk borrowers from that market. The resulting smaller subprime market would include the neediest borrowers. The commenters stated that these higher risk borrowers would pay more because lower risk borrowers would not be present to subsidize them, and the market's high fixed costs would be distributed across fewer borrowers.

One industry group also suggested that a significantly smaller subprime market for private lenders would drive some lenders out of business and translate into less competition.

While some industry commenters welcomed the entrance of the GSEs into the subprime market because their presence would bring stability and standardize business practices, the

commenters also expressed concern that unrealistically high goals could force the GSEs to jump into the market in a manner that negatively distorts underwriting and pricing. These commenters contended that the GSEs could bring capital and standards up, but that they must gradually and carefully enter the subprime market to have a positive effect. They strongly urged HUD to lower the goals to encourage the GSEs to expand their subprime activities at a measured pace.

Some commenters suggested that bonus points, or other incentives for the GSEs' purchases of certain nonprime loans, could foster more deliberate and prudent purchases by the GSEs of subprime loans. One lender also suggested that incentives could be granted to the GSEs for other underserved market segments, such as manufactured homes, minority first time buyers, and nonprime first-time buyers.

**HUD's Determination.** To date, the GSEs' involvement in the subprime market has benefited two types of borrowers: "A" risk and "near A" risk. The first group consists of borrowers with risk profiles similar to "A" borrowers, but receive mortgages from a subprime lender. The GSEs' outreach and education efforts increase the likelihood that "A" borrowers will use cheaper prime lenders for refinance mortgages, and reduce their reliance on subprime firms. The second group, borrowers who are near A credit risks, has growing access to mortgage products offered by the GSEs as these borrowers are increasingly served by GSE seller/servicers.

The GSEs have been prudent in their pursuit of subprime lending, focusing on the top part of the market, the "A-minus" and "Alt A" segments. A-minus mortgages are typically those where borrowers have less than perfect credit. Alt A mortgages are originated to borrowers who cannot document all of the underwriting information in the application but generally have FICO scores similar to those in the prime market. The GSEs' subprime products are integrated into their automated underwriting systems and are approved based on mortgage scoring models. These models have proven over the years to be an effective tool in limiting risk layering. The GSEs charge lenders higher fees for guaranteeing these loans. As a result these higher risk loans are priced above those offered to prime borrowers but below what subprime lenders would otherwise charge for these loans.

The GSEs' presence in the subprime mortgage market benefits many low-income and minority borrowers whose

risk profiles differ markedly from borrowers who qualify for prime mortgage products. Millions of Americans with less than perfect credit or who cannot meet some of the tougher underwriting requirements of the prime market for reasons such as inadequate income documentation, limited downpayment or cash reserves, or the desire to take more cash out in a refinancing than conventional loans allow, rely on subprime lenders for access to mortgage financing. If the GSEs reach deeper into the subprime market, more borrowers will benefit from the advantages that greater stability and standardization create.

#### i. Consequences of the Goals for Mortgage Defaults; Neighborhood Impacts

**Summary of Comments.** HUD received several comments concerning the impact of mortgage default rates on neighborhoods. Comments from mortgage insurance companies highlighted that the higher goals will likely lead to more expanded affordable housing products as well as higher foreclosures. Affordable products present challenges to borrowers and lenders. For borrowers, qualifying for an affordable mortgage does not insure they have a clear understanding of the risks of homeownership. Where aggressive affordable products are aimed at qualifying borrowers for home loans rather than qualifying families for homeownership, lenders need to be cautious of products that test the limits of borrowers' credit capabilities. Affordable products that have been introduced into the market under favorable economic conditions can experience increasing defaults and foreclosures during periods of higher interest rates, higher unemployment and/or lower house price appreciation rates. One commenter indicated that 15 percent or more of borrowers in some affordable housing products could experience default in an economic downturn.

As defaults on affordable products rise, inner city neighborhoods can be especially hard hit. A large number of foreclosures in an area may lead to abandoned properties. While foreclosures devastate borrowers who lose their homes and damage borrowers' credit history, foreclosures also weaken the neighborhoods where the properties are located.

The potential for affordable lending products to result in higher foreclosure during a less prosperous economic environment was echoed in Freddie Mac's comments. Its comment discussed how too many defaults in one

neighborhood can lead to serious blight and disinvestment in the community. One commenter recommended that HUD establish safeguards against aggressive affordable products. The commenter suggested that HUD deny Housing Goal credit for GSE mortgage purchases that experience early-term serious defaults (e.g., delinquent 90 days or longer within 12 months of the date of origination).

The GSEs and community groups cautioned that the struggle to meet high goals for low-income groups could cause the GSEs to relax underwriting standards and/or extend loans to people who are unprepared. For example, the commenters pointed out that FHA default rates are higher than the conventional conforming market. High goals would encourage the GSEs to enter markets served by FHA. This incentive to extend credit to unprepared low-income people would rise if unexpected refinances decreased the proportion of goals-eligible units produced in the market.

**HUD's Determination.** HUD carefully reviewed the comments regarding mortgage default rates. The Department believes that the GSEs' presence in underserved markets will be beneficial for neighborhoods. The GSEs have improved their underwriting methods to better identify risks in these markets, and also have instituted homebuyer education programs. An increased role for the GSEs' seller-services in inner-city neighborhoods will improve competition, reduce high-cost lending, and reduce predatory lending. As described in Appendix A, families living in inner-city, high-minority neighborhoods often have to rely on subprime lenders as their main source of mortgage credit. Studies indicate that many of these borrowers obtaining high-cost loans could qualify for lower-cost, prime mortgage credit. An active GSE effort in these neighborhoods will encourage traditional, mainstream lenders to increase their lending activities in these historically underserved areas. This will offer additional funding options for those lower-income and minority borrowers who today may have to take out a high-cost loan in order to purchase or renovate a home or to refinance an existing mortgage. Reductions in predatory lending reduce the costs of mortgages and the chances of default. As a result, the Department believes that GSE participation is a net benefit to lower income neighborhoods.

#### j. Consequences of the Goals for Residents of Puerto Rico

*Summary of Comments.* Several associations stated that HUD's proposed affordable housing goals could be disadvantageous to residents of Puerto Rico, alleging that less than 10 percent of loans that are originated in the Puerto Rican market would qualify for the goals. These commenters were concerned that the GSEs might be unable to buy loans from Puerto Rico, and urged HUD to take special measures to ensure that owner and rental housing production are not deleteriously affected by the demographic and economic differences that exist between the mainland markets and the Puerto Rico market.

*HUD's Determination.* Loans purchased by the GSEs for properties in Puerto Rico are counted in the same manner as loans purchased on properties in any other location. Since underserved areas are defined as low-income and/or high-minority census tracts in metropolitan areas or counties in non-metropolitan areas, the overwhelming majority of loans purchased by the GSEs on properties in Puerto Rico count toward that goal. In fact, in 2003, Fannie Mae reported that 95 percent of the units it financed in Puerto Rico qualified for the underserved areas goal; the corresponding figure for Freddie Mac was 98 percent.

Relatively few of the loans in Puerto Rico that are purchased by the GSEs qualify for the two income-based goals. Despite this, HUD does not believe that the final housing goals will adversely affect Puerto Rico. In 2003, Puerto Rico accounted for only 0.2 percent of all units financed by Fannie Mae and only 0.1 percent of all units financed by Freddie Mac. Thus overall performance on these broad national goals is not materially affected by the characteristics of loans purchased by the GSEs in Puerto Rico.

Apparently many lower-income families in Puerto Rico rely on consumer finance companies for financing their homes. Since such financing is typically more expensive to borrowers than traditional mortgages, this suggests that the GSEs could play an important role, working with mortgage originators, to better develop the mortgage market in Puerto Rico.

#### 4. Determinations Regarding the Specification and Levels of the Home Purchase Subgoals

##### a. Overview

Given that the past average performance of the GSEs in the home

purchase market has been below market levels, and the Administration's emphasis on increasing homeownership opportunities, including those for low- and moderate-income and minority borrowers, HUD proposed to set Home Purchase Subgoals for GSE mortgage purchase activities to increase financing opportunities for low- and moderate-income, underserved, and special affordable borrowers who are purchasing single-family homes.

Specifically, the Department proposed Home Purchase Subgoals for home purchase loans that qualify for the Housing Goals. The purpose of the Home Purchase Subgoals is to ensure that the GSEs focus on financing home purchases for the homeowners targeted by the Housing Goals. The Department believes that the establishment of Home Purchase Subgoals will place the GSEs in an important leadership position in the Housing Goals categories, while also facilitating homeownership. The GSEs have years of experience in providing secondary market financing for single-family properties and are fully capable of exerting such leadership.

The focus of these Subgoals on home purchase loans meeting the Housing Goals will also help address the racial and income disparities in homeownership that exist today. As noted earlier, although minority homeownership has grown, the homeownership rate for African-American and Hispanic families is still approximately 25 percentage points below that for non-Hispanic white families. The focus of the Subgoals on home purchase will also increase the GSEs' support of first-time homebuyers, a market segment where they have lagged primary lenders.

*Summary of Comments.* Fannie Mae claimed that the proposed Subgoals are not necessary and are, in fact, duplicative of the broader goals structure. Fannie Mae asserted that it is already a leader in financing home purchases, even in a period of aggressive refinancings. In addition, Fannie Mae stated that subgoals add complexity to the mortgage market and contribute to a loss of liquidity, and suggested that the proposed Subgoals do not reflect recent market experience because affordability may decline and HUD may mistreat missing data when formulating subgoals. Fannie Mae also stated that HUD improperly exercised its authority in proposing the Subgoals.

Specifically, Fannie Mae contended that a complex subgoal structure harms liquidity and that when Fannie Mae needs to stretch in one market to meet a goal, it may have to reduce its willingness to purchase mortgages in

another market. Fannie Mae stated that conflicts between the goals arise because the goals are set as a percentage of business, and fulfilling the numerator of one goal adds to the denominator of the other goals. Fannie Mae asserted that the GSEs could be forced to abstain from buying non-goal eligible mortgages that would count in the denominator, but that would not benefit its calculation of goals performance in the numerator. In Fannie Mae's view, its own abstention from buying implies an illiquid market.

Other commenters affirmed Fannie Mae's comments and expressed concern that, given the market leadership of the GSEs, the manner in which home purchases are counted toward the Subgoals could distort the lending market.

In addition, both Fannie Mae and Freddie Mac asserted that FHEFSSA requires that HUD consider each of the six statutory factors set forth in sections 1332(b) and 1334(b) of the statute in setting the levels of any Subgoals within those Housing Goals. Freddie Mac objected to the home purchase Subgoals because it claimed these Subgoals would constitute micromanagement of the GSEs' business decisions. Freddie Mac also noted that, in the past, HUD has declined to implement subgoals for that very reason.

Several commenters expressed the view that HUD had overestimated available purchase money mortgages and noted that if Subgoals on these types of mortgages are set too high, adverse market distortions will occur.

Other commenters contended that, regardless of the level of the Subgoals, a subgoal that targets home purchase mortgages unfairly allocates credit toward home buying rather than mortgage refinances. These commenters asserted that this credit allocation is unfair in that it penalizes borrowers who want to lower mortgage costs or improve their homes. They also contended that credit allocation that promotes purchase mortgages could push refinance borrowers into high-cost loans rather than conforming, GSE-eligible mortgages. To combat such effects, one organization suggested separate subgoals for both purchase money mortgages and refinances, with the overall low- and moderate-income goal as the weighted average of the different subgoals.

Commenters also objected to mortgage purchase subgoals targeting only those loans originated in metropolitan areas because this geographic limitation allocates credit at the expense of residents of rural communities. The commenters stated that Congress

charged the GSEs in their charters to “promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas).” One commenter stated that the lack of detailed HMDA data in rural areas makes market size estimates difficult, but suggested that other data from private vendors could provide acceptable measures (without offering any specific sources).

*HUD’s Determination.* Home purchase is a high national priority. The comments received and research reviewed document many studies revealing the desire of Americans to own their own home. HUD finds that the proposed home purchase subgoal furthers the statutory objectives of FHEFSSA. HUD set the level of the home purchase subgoal prudently. Details of HUD’s methodology are found in Appendices A and D of this final rule and in chapter 3 of the Economic Analysis that accompanies the rule. Rather than distorting the market, the home purchase subgoal facilitates the desire of many Americans to use the market to acquire their own home.

Several commenters asked HUD to extend the counting for the home purchase subgoal to rural areas even though data for rural areas is sparse. HUD disagrees. Although HMDA data for rural areas has improved, it is still too incomplete to support extending the counting system. Alternative sources from private lenders are similarly flawed. While HMDA’s reporting of non-metropolitan areas has improved over the years, it continues to be unreliable. In 2001, 3,757 (3,280 of which were small banks) of the 4,394 non-metropolitan-area banks did not report under HMDA. In that same year, 324 (246 of which were small thrifts) of the 458 non-metropolitan-area thrift institutions did not report under HMDA.

Except for Fannie Mae’s recent performance in the Special Affordable and Low- and Moderate-Income categories, the GSEs have lagged the market in purchasing single-family, owner-occupied loans that qualify for the Housing Goals. In 2003, Fannie Mae continued to lag the market in financing properties located in underserved areas

while Freddie Mac lagged the market in all three goals-qualifying categories. The Department’s analysis reveals that there is ample room for both Fannie Mae and Freddie Mac to improve their performance in purchasing home loans that qualify for the Housing Goals, particularly in important market segments such as the minority, first-time homebuyer market.

Both GSEs’ funding of mortgages for first-time homebuyers lags the market’s provision of funding for these families, and the lag is particularly large for first-time minority homebuyers. Table 2 compares the GSEs’ funding of mortgages for first-time homebuyers with market loan originations for first-time homebuyers. This table shows that first-time homebuyers represented 37.6 percent of market loan originations, compared with 26.5 percent of the GSEs’ purchases; thus, the GSEs fell substantially short of the market originations ratio for first-time homebuyers, over the period 1999–2001.

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Table 2

**First-time Homebuyer Mortgages as a Share of All Conventional Conforming  
Home Purchase Mortgages, for GSEs' Purchases and Market Originations,  
1999-2001 Averages<sup>1</sup>**

	Fannie Mae	Freddie Mac	Both GSEs	Market
All Race/Ethnicity Groups	26.5% <sup>2</sup>	26.5%	26.5%	37.6% <sup>4</sup>
African-American and Hispanic	4.0%	3.4%	3.8%	6.9%
Minority	6.6% <sup>3</sup>	5.8%	6.2%	10.6% <sup>5</sup>

<sup>1</sup> The first-time homebuyer definition for the market analysis is homebuyers who have never owned a home. The definition for the GSEs is purchasers who have not owned a home within the past three years.

Interpretations:

<sup>2</sup> First-time homebuyer mortgages were 26.5% of all home purchase mortgages purchased by Fannie Mae in 1999-2001

<sup>3</sup> Minority first-time homebuyer mortgages were 6.6% of all home purchase mortgages purchased by Fannie Mae in 1999-2001

<sup>4</sup> First-time homebuyer mortgages were 37.6% of all home purchase mortgage originations in 1999-2001

<sup>5</sup> Minority first-time homebuyer mortgages were 10.6% of all home purchase mortgage originations in 1999-2001

For minority first-time homebuyers, the GSE ratio was 6.2 percent, compared to a market originations ratio of 10.6 percent. For African-American and Hispanic first-time homebuyers, the GSE ratio was 3.8 percent, compared to a market originations ratio of 6.9 percent. For first-time homebuyers, particularly first-time minority homebuyers, both GSEs substantially lag the private conventional conforming market.

As detailed in Appendix A to this rule, evidence suggests that there is a significant population of potential homebuyers who are likely to respond well to increased homeownership opportunities produced by increased GSE purchases in this area. Immigrants and minorities, in particular, are expected to be a major source of future homebuyers. Furthermore, studies indicate the existence of a large untapped pool of potential homeowners among the rental population. Indeed, the GSEs' recent experience with new outreach and affordable housing initiatives confirms the existence of this potential.

The Department therefore is establishing through this rule Subgoals for home purchase loans that qualify for the three Housing Goals to encourage the GSEs to take a leadership position in creating homeownership financing opportunities within the categories that Congress expressly targeted with the Housing Goals.

**b. HUD's Determinations Regarding the Home Purchase Subgoals**

Under FHEFSSA, HUD is authorized to establish nonenforceable Subgoals within the Low- and Moderate-Income Housing Goal and the Underserved Areas Housing Goal. HUD also is authorized under FHEFSSA to establish enforceable Subgoals within the Special Affordable Housing Goal. The Administration has proposed, as part of GSE regulatory reform, that Congress authorize HUD to establish a separate Home Purchase Goal that would include enforceable components. Pending the enactment of any such legislation, HUD is establishing the Home Purchase Subgoals described in this final rule under its current statutory authority.

HUD stated in the preamble to the proposed rule that in setting a subgoal, "[c]urrent law does not require that HUD consider the statutory factors set forth in FHEFSSA prior to establishing or setting the level of Subgoals." (69 FR 24244.) HUD's interpretation of this portion of FHEFSSA is unchanged. Each of the subsections identifying the factors for consideration indicates that the factors are to be considered in setting

each respective goal; no mention is made of the subgoals. However, despite the absence of any statutory requirement to consider the listed factors in setting the levels of the subgoals, HUD has nevertheless carefully considered each of these factors in setting the subgoal levels in this final rule.

The following sections provide an overview of HUD's reasons for establishing the Subgoals, which are detailed in the Appendices to this rule.

**(i) The GSEs Have the Ability To Lead the Market**

The GSEs have the ability to lead the primary market for mortgages on single-family owner-occupied properties, which are the GSEs' principal line of business. Both GSEs have long experience in the home purchase mortgage market, and therefore there is no issue of the degree to which they have penetrated this market. In addition, because the Subgoals focus on homeownership opportunities and, thus, do not include refinance loans, there is no issue regarding potentially large year-to-year changes in refinance mortgage volumes, which affect the magnitude of the denominator in calculating performance percentages under the Housing Goals, as experienced in the heavy refinance years of 1998 and 2001–2003.

Both GSEs have not only been operating in the single-family owner mortgage market for years, they have been the dominant players in that market, funding 57 percent of mortgages on single-family owner-occupied residences financed between 1999 and 2002. As discussed in Section G of Appendix A to this rule, their underwriting guidelines are industry standards and their AUS are widely used in the mortgage industry.

**(ii) The GSEs' Performance Relative to the Market**

Even though the GSEs have had the ability to lead the home purchase market, their past average performance (1993–2003, 1996–2003, and 1999–2003) has been below market levels. During 2002 and 2003, Fannie Mae improved its performance enough to lead the special affordable and low-mod markets for home purchase loans, but Fannie Mae continued to lag the primary market in funding homes in underserved areas. The subgoals will ensure that Fannie Mae maintains and further improves its above-market performance in the special affordable and low-mod markets, and also becomes a market leader in funding underserved areas. Freddie Mac, although it has also improved its recent performance,

continues to lag behind the primary market on all housing goal categories. The subgoals will ensure that Freddie Mac erases its gaps with the market and takes a leadership position as well. The type of improvement needed for Freddie Mac to meet these new subgoals was demonstrated by Fannie Mae during 2001–2003. For example, Fannie Mae increased its low-mod purchases from 40.8 percent of its single-family-owner business in 2000 to 45.3 percent in 2002 to 47.0 percent in 2003.

**(iii) Disparities in Homeownership and Credit Access Remain**

HUD notes that there remain troublesome disparities in our housing and mortgage markets, even after the "revolution in affordable lending" and the growth in homeownership that has taken place since the mid-1990s. As noted previously in the discussion of the goals, the homeownership rate for African-American and Hispanic households remains 25 percentage points below that of white households. In 2002, the mortgage denial rate for African-American borrowers was over twice that for white borrowers, even after controlling for the income of the borrower.

HUD also notes that there is growing evidence that inner city neighborhoods are not always being adequately served by mainstream lenders. Some have concluded that a dual mortgage market has developed in our nation, with conventional mainstream lenders serving mainly white families living in the suburbs and FHA and subprime lenders serving minority families concentrated in inner city neighborhoods. In addition to the unavailability of mainstream lenders, families living in high-minority neighborhoods generally face many additional hurdles, such as lack of cash for a downpayment, credit problems, and discrimination.

Immigrants and minorities are projected to account for almost two-thirds of the growth in the number of new households over the next ten years. As emphasized throughout this preamble and the Appendices to this rule, changing population demographics will result in a need for the primary and secondary mortgage markets to meet nontraditional credit needs, respond to diverse housing preferences and overcome information and other barriers that many immigrants and minorities face. HUD finds that the GSEs must increase their efforts towards providing financing for these families.

(iv) **There Are Ample Opportunities for the GSEs To Improve Their Performance in the Home Purchase Market**

Home purchase loans that qualify for the Housing Goals are available for the GSEs to purchase, which means they can improve their performance and lead the primary market in purchasing loans for lower-income borrowers and properties in underserved areas. Three indicators of this have already been discussed.

First, the affordable lending market has shown an underlying strength over the past few years that is unlikely to vanish (without a significant increase in interest rates or a decline in the economy). Since 1999, the shares of the home purchase market accounted for by the three Housing Goal categories are as follows: 16.3 percent for special affordable, 31.4 percent for underserved areas, and 44.1 percent for low- and moderate-income.

Second, market share data reported in section G of Appendix A to this rule show that almost half of newly-originated loans that qualify for the Housing Goals are not purchased by the GSEs. As noted above, the situation is even more extreme for special submarkets, such as the minority first-time homebuyer market where the GSEs have only a minimal presence. In terms of the overall mortgage market (both conventional and government), the GSEs funded only 24 percent of all first-time homebuyers and 17 percent of minority first-time homebuyers between 1999 and 2001. Similarly, during the same period, the GSEs funded only 40 percent of first-time homebuyers in the conventional conforming market, and only 33 percent of minority first-time homebuyers in that market.

Finally, the GSEs' purchases that can count toward the Subgoal are not limited to new mortgages that are originated in the current calendar year. The GSEs can purchase loans from the substantial, existing stock of affordable loans held in lenders' portfolios, after these loans have seasoned and the GSEs have had the opportunity to observe their payment performance. In fact, based on Fannie Mae's recent experience, the purchase of seasoned loans is at present one strategy employed for purchasing Housing Goals-qualifying loans and meeting the goals.

The current low homeownership rate of minorities and others living in inner

cities suggests that there will be considerable growth in the origination of CRA loans in urban areas. For banks and thrifts, selling their CRA originations will free up capital to make new CRA loans. As a result, the CRA market segment provides an opportunity for the GSEs to expand their affordable lending programs. As explained in Appendix A to this rule, Fannie Mae and Freddie Mac have already started developing programs to purchase CRA-type loans on a flow basis as well as after they have seasoned.

While the GSEs can choose any strategy for leading the market, this leadership role can likely be accomplished by building on the many initiatives and programs that the enterprises have already started, including: (1) Their outreach to underserved markets and their partnership efforts that encourage mainstream lenders to move into these markets; (2) their incorporation of greater flexibility into their purchase and underwriting guidelines, (3) their development of new products for borrowers with little cash for a downpayment and for borrowers with credit blemishes or non-traditional credit histories; (4) their targeting of important markets where they have had only a limited presence in the past, such as the markets for minority first-time homebuyers; (5) their purchases of both newly-originated and seasoned CRA loans; and (6) their use of automated underwriting technology to qualify creditworthy borrowers that would have been deemed not creditworthy under traditional underwriting rules.

The experience of Fannie Mae and Freddie Mac in the subprime market indicates that they have the expertise and experience to develop technologies and new products that allow them to enter new markets in a prudent manner. Given the innovativeness of Fannie Mae and Freddie Mac, other strategies will be available as well. In fact, a wide variety of quantitative and qualitative indicators suggest that the GSEs have the expertise, resources and financial strength to improve their affordable lending performance enough to lead the home purchase market for special affordable, low- and moderate-income, and underserved areas loans. The recent improvement in the affordable lending performance of the GSEs, and particularly Fannie Mae, further demonstrates the GSEs' capacity to lead the home purchase market.

c. **Structure and Levels of the Home Purchase Subgoals**

Under this rule, performance on the Home Purchase Subgoals will be calculated as Housing Goal-qualifying percentages of the GSEs' total purchases of mortgages that finance purchases of single-family, owner-occupied properties located in metropolitan areas, based on the owner's income and the location of the property. Specifically, for each GSE the following Subgoals would apply. (A "home purchase mortgage" is defined as a residential mortgage for the purchase of an owner-occupied single-family property.)

- 45 percent of home purchase mortgages purchased by the GSE in metropolitan areas must qualify under the Low- and Moderate-Income Housing Goal in 2005, with this share rising to 46 percent in 2006 and 47 percent in both 2007 and 2008;
- 32 percent of home purchase mortgages purchased by the GSE in metropolitan areas must qualify under the Underserved Areas Housing Goal in 2005, with this share rising to 33 percent in both 2006 and 2007 and 34 percent in 2008; and
- 17 percent of home purchase mortgages purchased by the GSE in metropolitan areas must qualify under the Special Affordable Housing Goal in both 2005 and 2006, with this share rising to 18 percent in both 2007 and 2008.

Calculation of performance under the Home Purchase Subgoals will be in terms of numbers of mortgages, not numbers of units. This is consistent with the basis of reporting in HMDA data, which were HUD's point of reference in establishing the Home Purchase Subgoal levels. HMDA data are reported in terms of numbers of mortgages in metropolitan areas.

These Home Purchase Subgoals are shown in Table 3, along with information on what the GSEs' performance on the Subgoals would have been if they had been in effect for 1999–2003 (under the proposed counting rules for 2005–2008). Table 3 also presents HUD's estimates of the average shares of mortgages on owner-occupied single-family properties in metropolitan areas that were originated in 1999–2003 that would have qualified for these Home Purchase Subgoals.

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**Table 3**  
**Shares of GSEs' Acquisitions of Home Purchase Mortgages Qualifying for the**  
**Subgoals, 1999-2003, and Subgoals for 2005-08**

Subgoal Category	Subgoal-Qualifying Mortgage Purchases <sup>1</sup>					Subgoals				Market <sup>2</sup>				Average (Unweighted)	
	1999	2000	2001	2002	2003	2005	2006	2007	2008	1999	2000	2001	2002		2003
<u>Low- and Moderate-Income</u>															
Fannie Mae	39.2%	40.1%	41.7%	43.6%	47.5%										
Freddie Mac	40.0%	41.7%	39.8%	42.1%	44.2%	45%	46%	47%	47%	44.0%	43.3%	41.6%	42.5%	45.6%	43.4%
Market															
<u>Underserved Areas</u>															
Fannie Mae	25.3%	29.0%	29.8%	32.3%	32.0%	32%	33%	33%	34%						
Freddie Mac	25.6%	27.3%	27.3%	31.7%	29.0%					30.2%	31.7%	30.7%	31.8%	32.5%	31.4%
Market															
<u>Special Affordable</u>															
Fannie Mae	12.5%	13.4%	14.7%	15.8%	17.7%	17%	17%	18%	18%						
Freddie Mac	12.8%	14.5%	13.9%	15.1%	16.2%					17.1%	16.8%	15.4%	15.4%	16.8%	16.3%
Market															

<sup>1</sup> Based on counting rules for 2005-08, defined using 2000 Census data and geography, including metropolitan areas as defined by OMB on June 30, 2003. Subgoals apply to metropolitan areas only. See text for definition of subgoal-qualifying mortgages.

<sup>2</sup> Conventional conforming market for home purchase mortgages in metropolitan areas (excluding the B&C portion of the subprime market.)

d. Counting Mortgages Toward the Home Purchase Subgoals

The Department is amending 24 CFR 81.15 to add a new paragraph (i) that would clarify that the procedures in § 81.15 generally govern the counting of home purchase mortgages toward the Home Purchase Subgoals in §§ 81.12, 81.13 and 81.14. The new paragraph provides, however, that the numerator and denominator for purposes of counting performance under the Subgoals are comprised of numbers of home purchase *mortgages* in metropolitan areas, rather than numbers of *dwelling units*. Paragraph (i) also provides that, for purposes of addressing missing data or information for each Subgoal, the procedures in § 81.15(d) shall be implemented using numbers of home purchase mortgages in metropolitan areas and not single-family, owner-occupied dwelling units. Finally, the new paragraph provides that where a single home purchase mortgage finances the purchase of two or more owner-occupied units, the mortgage shall count once toward each Subgoal that applies to the GSE's mortgage purchase.

5. Low- and Moderate-Income Housing Goal, § 81.12

This section discusses the Department's consideration of the

statutory factors in arriving at, and the comments received on, the new housing goal level for the Low- and Moderate-Income Housing Goal, which targets mortgages on housing for families with incomes at or below the area median income. After consideration of these factors, this final rule establishes the goal for the percentage of dwelling units to be financed by each GSE's mortgage purchases at 52 percent for 2005, 53 percent for 2006, 55 percent for 2007, and 56 percent for 2008.

Additional information analyzing each of the statutory factors is provided in Appendix A, "Departmental Considerations to Establish the Low- and Moderate-Income Housing Goal," and Appendix D, "Estimating the Size of the Conventional Conforming Market for each Housing Goal."

a. Market Estimate for the Low- and Moderate-Income Housing Goal

The Department estimates that dwelling units serving low- and moderate-income families will account for 51–56 percent of total units financed in the overall conventional conforming mortgage market during the period 2005 through 2008. HUD has developed this range, rather than a specific point estimate, to account for the projected effects of different economic and affordability conditions that can

reasonably be anticipated. HUD estimates that the low-and-moderate-income share of the market averaged 57 percent between 1999 and 2002.

b. Past Performance of the GSEs Under the Low- and Moderate-Income Housing Goal

A number of changes in goal-counting procedures were adopted as part of HUD's Housing Goals final rule published on October 31, 2000 (65 FR 65044) (Housing Goals 2000 final rule). Thus, it is necessary to provide information using several different measures in order to track performance on the Low- and Moderate-Income Housing Goal over the 1996–2003 period. Table 4 shows performance under these measures.<sup>14</sup>

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<sup>14</sup> The Freddie Mac 2002 figures in Table 4 differ from the corresponding figures in Table 3 in HUD's Proposed Rule. Subsequent to publication of the Proposed Rule, HUD discovered that HUD had credited some units toward Freddie Mac's Low- and Moderate-Income Housing Goal in 2002 that had been previously counted toward the goal in 2001. The units were associated with a large year-end Freddie Mac mortgage purchase transaction in 2002. Because HUD's regulations prohibit double counting, HUD has recalculated Freddie Mac's 2002 Low- and Moderate-Income Housing Goal performance. The recalculation also reflects correction of some coding errors discovered in HUD's recent review.

**Table 4**  
**GSE Performance on the Low- and Moderate-Income Housing Goal, 1996-2003, and Goals for 2005-08**

	1996	1997	1998	1999	2000	2001 <sup>1</sup>	2002 <sup>1</sup>	2003 <sup>1</sup>	2005-08 Goals		
									2005	2006	2007
Goal Levels:	40%	42%	42%	42%	42%	50%	50%	50%	52%	53%	55%
Fannie Mae Goal Performance											
Official	45.6%	45.7%	44.1%	45.9%	49.5%	51.5%	51.8%	52.3%			
2001-03 Baseline <sup>2</sup>	46.8%	47.5%	45.1%	46.8%	51.3%	49.2%	49.0%	48.7%			
With 2005 Assumptions <sup>3</sup>				<b>46.3%</b>	<b>51.2%</b>	<b>48.7%</b>	<b>47.9%</b>	<b>49.5%</b>			
Freddie Mac Goal Performance											
Official	41.1%	42.6%	42.9%	46.1%	49.9%	53.2%	50.5%	51.2%			
2001-03 Baseline <sup>2</sup>	41.2%	42.7%	43.2%	46.6%	50.6%	47.7%	46.1%	45.0%			
With 2005 Assumptions <sup>3</sup>				<b>46.0%</b>	<b>50.2%</b>	<b>47.0%</b>	<b>44.6%</b>	<b>45.3%</b>			

<sup>1</sup> Goal level and official performance in 2001-03 are not directly comparable with goal level and performance in 1996-2000, because the goal performance counting rules for 2001-03 differ from those that were in effect for 1996-2000, as discussed in the text. Goal performance is based on official HUD results. Freddie Mac's goal performance in 2002 has been revised due to the double-counting of loans in 2001 and 2002 and correction of coding errors, as discussed in the text.

<sup>2</sup> "2001-03 Baseline" represents performance under current scoring rules (which exclude bonus points and Freddie Mac temporary adjustment factor), without any use of 2000 census data in estimating area median incomes; census tract boundaries as of the 1990 census; and metropolitan area boundaries prior to their re-specification by the Office of Management and Budget in June, 2003.

<sup>3</sup> "2005 Assumptions" represents performance under current scoring rules with 2000 census data used in estimating area median incomes; census tract boundaries as of the 2000 census; and the Office of Management and Budget's specification of metropolitan area boundaries as of June, 2003. These figures, also shown in Appendix Table A.10, do not adjust performance for the revised treatment of missing data provided in this final rule.

Specifically, the following changes were made in counting procedures for measuring performance on the Low- and Moderate-Income Housing Goal for 2001–2003. HUD:

(1) Established “bonus points” (awarding double credit) for purchases of low- and moderate-income mortgages on small (5–50 unit) multifamily properties and, above a threshold level, mortgages on two-to-four unit owner-occupied properties;

(2) Established a “temporary adjustment factor” (1.35 units credit, as revised by Congress for 2001–2003 from HUD’s 1.2 unit credits in the Housing Goals 2000 final rule) that applied to Freddie Mac’s purchases (but not Fannie Mae’s purchases) of low- and moderate-income mortgages on large (more than 50-unit) multifamily properties; and

(3) Revised procedures that HUD had instituted regarding the treatment of missing data on unit affordability, the use of imputed or proxy rents for determining goal credit for multifamily mortgages, and the eligibility for goals credit for certain qualifying government-backed loans.

Based on the counting rules in effect at that time for 1996–2000, as shown under “official performance” for 1996–2000 in Table 4, Low- and Moderate-Income Housing Goal performance for Fannie Mae was consistently in the 44–46 percent range over the 1996–1999 period, before jumping to a peak of 49.5 percent in 2000. Freddie Mac’s performance started at a lower level, but then increased in several steps, from 41–43 percent in 1996–1998 to 46.1 percent in 1999, and a record level of 49.9 percent in 2000. That was the only year prior to 2001 in which Freddie Mac’s performance exceeded Fannie Mae’s performance on this goal.

Based on the then current counting rules, including the bonus points and TAF, as shown under “official performance” in Table 4, Low- and Moderate-Income Housing Goal performance was 51.5 percent for Fannie Mae in 2001, 51.8 percent in 2002, and 52.3 percent in 2003. For Freddie Mac, performance was 53.2 percent in 2001, 50.5 percent in 2002, and 51.2 percent in 2003.

Immediately beneath the official Low- and Moderate-Income Housing Goal performance percentages in Table 4 are figures showing the GSEs’ low- and moderate-income purchase percentages on a consistent basis for the entire 1996–2003 period. The assumptions used were the counting rules established in HUD’s Housing Goals 2000 final rule except that bonus points and the Freddie Mac TAF (which were

terminated at the end of 2003) are not applied. These figures are termed the “2001–2003 baseline assumptions.” For 1996–2000 these figures differ from the official performance figures because they incorporate the revised counting procedures described under point (c), above, which were not reflected in the official performance figures at that time. For 2001–2003 both sets of figures incorporate the revised counting procedures, but the baseline does not incorporate the bonus points and the Freddie Mac TAF.

In terms of the 2001–2003 baseline measure, both Fannie Mae’s and Freddie Mac’s low- and moderate-income performance reached its maximum in 2000 (Fannie Mae at 51.3 percent and Freddie Mac at 50.6 percent). Baseline performance fell somewhat for both GSEs in 2001, 2002, and 2003. Fannie Mae’s baseline performance last year exceeded the level attained in 1999, but Freddie Mac’s performance fell to the lowest level since 1998.

Overall, both GSEs’ performance exceeded HUD’s Low- and Moderate-Income Housing Goals by significant margins in 1996–1999, and by wide margins in 2000. New, higher goals were established for 2001–2003, and despite somewhat lower performance than the level attained in 2000, both GSEs’ official performance exceeded the new goal levels in each year 2001–2003, with the inclusion of the bonus points and the TAF.

The decline in baseline performance in 2001–2003 can be attributed in large measure to the mortgage refinance wave that occurred in those years. Fannie Mae’s overall volume of mortgage purchases (in terms of numbers of housing units) rose from 2.2 million in 2000 to 4.7 million in 2001, 6.4 million in 2002, and then to 10.1 million in 2003. Similarly, Freddie Mac’s volume rose from 1.6 million in 2000 to 3.3 million in 2001, 4.3 million in 2002, and then to 5.8 million in 2003. For each GSE the increase in volume each year can be largely attributed to increases in purchase volumes for refinance mortgages relative to home purchase mortgages. For each GSE, the fraction of mortgages that qualified as Low- and Moderate-Income was less for refinance mortgages than for home purchase mortgages.

For 2005–2008, HUD is expanding the affordability estimation of units with missing affordability information. In addition to multifamily units, the GSEs will also be able to use estimates of affordability for single-family rental units with missing rents and owner-occupied units with missing borrower incomes for determining goal credit.

HUD is also increasing the amount of the maximum allowed for affordability estimation for multifamily units.

Beneath the 2001–2003 baseline figures in Table 4 is another row of figures designated “With 2005 Assumptions.” These figures show the effects of applying 2000 Census data and the new specification of MSAs released by OMB in 2003 to the measurement of Low- and Moderate-Income purchase percentages with the same counting rules that were used for the 2001–2003 baseline in Table 4. The effect is to reduce the Goal-qualifying percentage by an average of 0.6 percentage points for Fannie Mae and 0.7 percentage points for Freddie Mac, over the 1999–2002 period.

However, for 2003, the effects are just the opposite—these assumptions increased Fannie Mae’s performance by 0.8 percentage point (from 48.7 percent to 49.5 percent) and Freddie Mac’s performance by 0.3 percentage point (from 45.0 percent to 45.3 percent). The difference in the direction of this impact between 1999–2002 and 2003 may be due to the need to apply estimation techniques in 1999–2002 but not in 2003. For 1999–2002 HUD had to estimate the effect based on data geocoded according to 1990 census tract definitions, while for 2003 the data were geocoded to 2000 census tracts. Further insight will be provided by analysis of data for 2004 and further years.

#### c. Low- and Moderate-Income Home Purchase Subgoal

The Department has determined to establish a Subgoal of 45 percent for each GSE’s purchases of home purchase mortgages on single-family owner-occupied properties in metropolitan areas which are for low- and moderate-income families in 2005, with this Subgoal rising to 46 percent in 2006 and 47 percent in both 2007 and 2008.

The purpose of this Subgoal is to encourage the GSEs to increase their acquisitions of home purchase loans for low- and moderate-income families, many of whom are expected to enter the homeownership market over the next few years. Table 5 provides basic information on both the GSEs’ low-mod performance and the primary market’s low-mod performance for the years 1999 to 2003. Since the same format will be followed for the other housing subgoals, several points are made about the information in the Table 5, prior to discussing the low-mod subgoal.

**Table 5**  
**Low- and Moderate Income Home Purchase Subgoals**

Subgoals Targets	2005		2006		2007		2008	
	45%		46%		47%		47%	
	Subgoal Qualifying Mortgage Purchases <sup>1</sup>		Freddie Mac		Conventional Conforming Market <sup>2</sup>		Market W/O B&C and LT \$15,000	
<u>Low-Mod</u>	Fannie Mae				Market W/O B&C			
1999	39.2%		40.0%		44.0%		43.5%	
2000	40.1%		41.7%		43.3%		42.6%	
2001	41.7%		39.8%		41.6%		41.1%	
2002	43.6%		42.1%		42.5%		42.1%	
2003	47.5%		44.2%		45.6%		45.2%	
<u>Weighted Average</u>								
1999-2003	42.9%		41.5%		43.5%		43.0%	
2001-2003	44.5%		41.9%		43.4%		43.0%	
<u>Unweighted Average</u>								
1999-2003	42.4%		41.6%		43.4%		42.9%	
2001-2003	44.3%		42.0%		43.2%		42.8%	
2002-2003	45.6%		43.2%		44.1%		43.7%	

<sup>1</sup> Based on counting rules for 2005-08, defined using 2000 Census data and geography, including metropolitan areas as defined by OMB on June 30, 2003. Subgoals apply to metropolitan areas only. See text for definition of subgoal-qualifying mortgages.

<sup>2</sup> Conventional conforming market for home purchase mortgages in metropolitan areas. Second column excludes mortgages with principal balance less than \$15,000.

*Average Performance Data.* In addition to individual year data, various averages of annual performance are provided at the bottom of Table 5 (1999–2003, 2001–2003, and 2002–2003); these averages provide a useful context for examining the feasibility of the subgoals and the degree to which they call for performance that is above past market levels. This table provides a picture of how much the low-mod subgoal targets move the GSEs above past market levels and how much of a stretch each subgoal will be for each GSE (as compared with that GSE's past performance). As will become clear below, Fannie Mae and Freddie Mac have shown different past performances, which means that the subgoal targets will appear to have different impacts on these two institutions.

*Definitions of Primary Market.* HUD's basic market definition is the conventional conforming market without B&C loans; in other words, the A-minus loans in the subprime market are included in the market definition but the more risky B&C portion is not included (see Appendix D of the final rule for further discussion of this). In its report for Freddie Mac, ICF indicated that small loans (those less than \$15,000) should be excluded from any analysis that dealt with loans that might be available for purchase by the GSEs. Therefore, data are provided in Table 5 for (a) the market without B&C loans and (b) the market without both B&C and small loans less than \$15,000. As shown in Table 5, dropping small loans reduces the low-mod share of the conventional conforming market by about one-half percentage point.

*Projected 2000-Based Data.* Table 5 is based on projected data that incorporates both 2000 Census geography and the new OMB definitions. Thus, the goals-qualifying percentages in this table differ from those reported earlier in this Preamble, the latter being historical, 1990-Census-based percentages. HUD had to reapportion the data for the years prior to 2003. For 2003, both HMDA and GSE data were defined in terms of 2000 Census geography, so no reapportionment was necessary; for this reason, the 2003 data are probably the most accurate. With these basics, the results for the low-mod subgoal can now be briefly summarized as follows:

*Low-Mod Subgoals Compared With Market.* The 45-percent subgoal for the first year (2005) is approximately two percentage points above 1999–2003 and 2001–2003 average market performance, one percentage point above 2002–2003 average market performance, and 0.6 percent (market without B&C loans) to

0.2 percent (market without both B&C and small loans) below peak market performance. The 46-percent subgoal for 2006 would add one percentage point to these comparisons, while the 47-percent subgoal for 2007 and 2008 would add two percentage points. For example, the 47-percent subgoal is approximately three percentage points above 2002–2003 average market performance, and 1.4 percent (market without B&C loans) to 1.8 percent (market without both B&C and small loans) above peak market performance.

*Low-Mod Subgoals Compared With Past Freddie Mac Performance.* To reach the 45-percent 2005 subgoal, Freddie Mac would have to improve its performance by 3.0 percentage points over its 2001–2003 average low-mod performance of 42.0 percent, by 1.8 percentage points over its 2002–2003 average low-mod performance of 43.2 percent, and by 0.8 percent over its previous peak performance of 44.2 percent in 2003. To reach the 47-percent subgoal, Freddie Mac would have to improve its performance by 3.8 percentage points over its 2002–2003 average low-mod performance, and by 2.8 percent over its previous peak performance.

*Low-Mod Subgoals Compared With Past Fannie Mae Performance.* To reach the 45-percent 2005 subgoal, Fannie Mae would have to improve its performance by 0.7 percentage points over its 2001–2003 average low-mod performance of 44.3 percent; Fannie Mae would meet the 45-percent subgoal based on its 2002–2003 average low-mod performance of 45.6 percent and its previous peak low-mod performance of 47.5 percent in 2003. To reach the 47-percent subgoal, Fannie Mae would have to improve its performance by 2.7 percent over its 2001–2003 average performance and by 1.4 percentage points over its 2002–2003 average performance; Fannie Mae would meet the 47-percent subgoal based on its previous peak performance of 47.5 percent in 2003.

The low-mod subgoal targets will be more challenging for Freddie Mac than Fannie Mae. The type of improvement needed to meet the new low-mod subgoal targets was demonstrated by Fannie Mae during 2001–2003, as Fannie Mae increased its low-mod purchases from 40.1 percent of its single-family-owner business in 2000 to 43.6 percent in 2002 to 47.5 percent in 2003, as shown in Table 5. The approach taken is for the GSEs to obtain their leadership position by staged increases in the subgoals; this will enable the GSEs to take new initiatives in a correspondingly staged manner to achieve the new subgoals each year. Thus, the increases in the housing subgoals are sequenced so that the GSEs can gain experience as they improve and move toward the new higher subgoal targets.

Section 4.b. above of this preamble, and Section I.3 of Appendix A to this

rule, discuss the reasons why the Department is establishing the Subgoal for low- and moderate-income loans, as follows: (1) The GSEs have the resources and the ability to lead the market in providing mortgage funding for low- and moderate-income families; (2) except for Fannie Mae's recent performance, the GSEs have historically (over periods such as 1993–2003, 1996–2003, and 1999–2003) not led the market, even though they have had the ability to do so; (3) troublesome disparities in our housing and mortgage markets indicate a continuing need for increased GSE activity; and (4) there are ample opportunities for the GSEs to improve their low- and moderate-income performance in the home purchase market.

Although single-family owner-occupied mortgages comprise their principal line of business, Freddie Mac has always lagged behind the primary market in financing mortgages for low- and moderate-income families. Over the past three years Fannie Mae has closed its historical gap with the market and now leads the primary market in funding mortgages for low- and moderate-income families. Because home purchase loans account for a major share of the GSEs' purchases, the establishment of this Subgoal will aid their performance under the overall Low- and Moderate-Income Housing Goal.

For the foregoing reasons, the Department believes that the GSEs, and particularly Freddie Mac, can do more to raise the share of their home loan purchases serving low- and moderate-income families. This can be accomplished by building on efforts that the enterprises have already started, including their new affordable lending products, their many partnership efforts, their outreach to inner city neighborhoods, their incorporation of greater flexibility into their underwriting guidelines, and their purchases of seasoned CRA loans. A wide variety of quantitative and qualitative indicators indicate that the GSEs have the resources and financial strength to improve their affordable lending performance enough to lead the market serving low- and moderate-income families.

#### d. Summary of Comments

The majority of comments that addressed the housing goals focused on the highest goal in year 2008 for the Low- and Moderate-Income Housing Goal. While some commenters, such as affordable housing policy advocacy groups and housing and consumer coalitions, expressed support for more

aggressive goals, stating that the goals should be set to challenge the GSEs to do more, most commenters expressed concerns about possible adverse effects on middle-income borrowers, including the potential for higher costs and for unrealistic goals to lead to credit allocation to the lower end of the housing market, thereby hindering the GSEs' ability to serve all homebuyers. Other concerns included issues related to HUD's market share methodology analysis and the effects of single-family refinance loans in high refinance years on the GSEs' ability to meet the higher goals. Many commenters recommended that HUD exempt refinances from the goals performance calculation. As described earlier in this rule, HUD is seeking public comments on how to address the effects of refinance loans when this annual volume is high. In addition, some expressed the belief that overly aggressive goals could weaken the FHA insurance program and could encourage over-investment in rental housing at a time when multifamily vacancy rates are high. HUD has addressed these concerns in earlier sections of this final rule preamble. Others felt that higher goal levels will encourage more investor-owned rental units that harm communities. Both Fannie Mae and Freddie Mac objected to the higher goal level for the Low- and Moderate-Income Goal. Each disputed HUD's market share analysis, citing the uncertainty of data, for example the size of the multifamily market, and the uncertainty about future economic conditions. Freddie Mac stated that HUD overestimated the low/mod market share by 4 percent. Both GSEs also stated that it was inappropriate to base the goals at the high end of market share ranges. Freddie Mac stated that this approach ignores the year-to-year variability of the market. Appendix D to this rule responds to these market issues raised by the GSEs.

With regard to the Low- and Moderate-Income Home Purchase Subgoal, most commenters did not address the subgoal levels proposed by HUD, and none specifically addressed the proposal levels for the Low- and Moderate-Income Subgoal. For those that did mention the subgoals, the comments were mixed with about half supportive of the subgoal proposals in general and half believing the subgoal levels were too high. Both GSEs commented on HUD's proposed subgoals. Fannie Mae stated that the levels were higher than any values observed in HMDA from 1999–2002, and that the concept was duplicative of the overall goal structure. Freddie Mac

stated that HUD should withdraw the home purchase subgoals or HUD should re-estimate the market using reasonable assumptions and set both the goal and subgoal levels no higher than the midpoint of the resulting ranges.

#### e. HUD's Determination

The Low- and Moderate-Income Housing Goal established in this final rule is reasonable and appropriate having considered the factors set forth in FHEFSSA. For 2001–2003, HUD set the level of the housing goal conservatively, relative to the Department's market share estimates, in order to accommodate a variety of economic scenarios. Moreover, current examination of the gaps in the mortgage markets, along with the estimated size of the market available to the GSEs, demonstrate that the number of mortgages secured by housing for low- and moderate-income families is more than sufficient for the GSEs to achieve the new goal.

Therefore, having considered all the statutory factors including housing needs, projected economic and demographic conditions for 2005 to 2008, the GSEs' past performance, the size of the market serving low- and moderate-income families, and the GSEs' ability to lead the market while maintaining a sound financial condition, HUD has determined that the annual goal for mortgage purchases qualifying under the Low- and Moderate-Income Housing Goal will be 52 percent for 2005, 53 percent in 2006, 55 percent in 2007, and 56 percent in 2008. This reflects a reduction in the upper end of the market share range from 57 percent to 56 percent since HUD's publication of its proposed rule, resulting from changes in estimating market share as described at the end of section 3 (a), above, and in section F of Appendix D to this rule.

Further, the Department is establishing a Subgoal for each GSE's purchases of home purchase mortgages on single-family owner-occupied properties in metropolitan areas which are for low- and moderate-income families of 45 percent in 2005, with this Subgoal rising to 46 percent in 2006, and 47 percent in both 2007 and 2008. The reasons for increasing the Low- and Moderate-Income Housing Goal are discussed in sections a and b, above, and the reasons for establishing a Home Purchase Subgoal at the stated levels are set forth in section c.

While the GSEs have lagged the primary market in financing owner and rental housing for low- and moderate-income families, they appear to have ample room to improve their

performance in that market. A wide variety of quantitative and qualitative indicators demonstrate that the GSEs have the expertise, resources and financial strength to improve their low- and moderate-income lending performance, including lending for low- and moderate-income home purchases, and achieve the levels of the goals being established.

#### 6. Central Cities, Rural Areas, and Other Underserved Areas Housing Goal, § 81.13

This section discusses the Department's consideration of the statutory factors in arriving at, and the comments received on, the new housing goal levels for the Central Cities, Rural Areas, and Other Underserved Areas Goal, which focuses on areas currently underserved by the mortgage finance system. After consideration of the factors and the comments received, this final rule establishes the goal for the percentage of dwelling units to be financed by each GSE's mortgage purchases at 37 percent in 2005, 38 percent in 2006 and 2007, and 39 percent in 2008.

The 1995 final rule provided that mortgage purchases count toward the Underserved Areas Housing Goal if such purchases finance properties that are located in underserved census tracts. At 24 CFR 81.2 of HUD's current regulations, HUD defines "underserved areas" for metropolitan areas (in central cities and other underserved areas) as census tracts where either: (1) The tract median income is at or below 90 percent of the area median income (AMI); or (2) the minority population is at least 30 percent and the tract median income is at or below 120 percent of AMI. The AMI ratio is calculated by dividing the tract median income by the MSA median income. The minority percentage of a tract's population is calculated by dividing the tract's minority population by its total population. For properties in non-metropolitan (rural) areas, mortgage purchases have counted toward the Underserved Areas Housing Goal where such purchases finance properties that are located in underserved counties. As discussed above under the heading "Definitions" in this final rule, HUD is changing this specification from the county level to the census tract level. Mortgages will count toward the Underserved Areas Housing Goal where such purchases finance properties that are located in census tracts where either (1) the median income in the tract does not exceed 95 percent of the greater of the median incomes for the non-metropolitan portions of the state or the

non-metropolitan portions of the nation as a whole, or (2) minorities comprise at least 30 percent of the residents of the tract and the median income in the tract does not exceed 120 percent of the greater of the median incomes for the non-metropolitan portions of the state or the non-metropolitan portions of the nation as a whole.

The level for the Underserved Areas Housing Goal is based on 2000 Census data on area median incomes and minority percentages for census tracts, MSAs, and the non-metropolitan portions of states and of the entire nation. HUD's analysis, which is set forth below and described in greater detail in Appendix B to this rule, is based on 2000 census data. The effect of using 2000 census data rather than 1990 data to determine whether areas are underserved increases the percentage of the GSEs' mortgage purchases in underserved areas by an estimated average of 5 percentage points for Fannie Mae and 4 percentage points for Freddie Mac, based on the geographic locations of properties financed by the GSEs' mortgage purchases in 1999 through 2003. This change reflects geographical shifts in population concentrations by income and minority status from 1990 to 2000.

After analyzing the statutory factors, HUD is: (a) establishing a Goal of 37 percent for the percentage of the total number of dwelling units financed by each GSE's mortgage purchases for

properties located in underserved areas for 2005, 38 percent for 2006 and 2007, and 39 percent for 2008; (b) establishing census tracts as the spatial basis for establishing whether properties in non-metropolitan (rural) areas count toward the Underserved Areas Housing Goal, in place of counties as in the definition stated above, for the reasons described below; and (c) also establishing a Subgoal of 32 percent of the total number of dwelling units financed by each GSE's purchases of home purchase mortgages in metropolitan areas for properties located in underserved areas of metropolitan areas for 2005, rising to 33 percent for 2006 and 2007, and 34 percent for 2008.

A short discussion of the statutory factors reviewed follows. Additional information analyzing each of the statutory factors is provided in Appendix B to this rule, "Departmental Considerations to Establish the Underserved Areas Housing Goal," and Appendix D to this rule, "Estimating the Size of the Conventional Conforming Market for each Housing Goal."

#### a. Market Estimate for the Underserved Areas Housing Goal

The Department estimates that dwelling units in underserved areas will account for 35–39 percent of total units financed in the overall conventional conforming mortgage market during the period 2005 through 2008. HUD has developed this range, rather than a specific point estimate, to accommodate

the projected effects of different economic and affordability conditions that can reasonably be anticipated. HUD estimates that the underserved areas market averaged 39 percent between 1999 and 2002.

#### b. Past Performance of the GSEs Under the Underserved Areas Housing Goal

As discussed above, a number of changes in goal-counting procedures were adopted as part of HUD's Housing Goals 2000 final rule. Thus it is necessary to provide information using several different measures in order to track changes in the GSEs' performance on the Underserved Areas Housing Goal over the 1996–2003 period. These are shown in Table 6.<sup>15</sup> The same changes in counting rules described for the Low- and Moderate-Income Housing Goal are applicable to the Underserved Areas Housing Goal.

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<sup>15</sup> The Freddie Mac 2002 figures in Table 6 differ from the corresponding figures in Table 4 in HUD's Proposed Rule. Subsequent to publication of the Proposed Rule, HUD discovered that HUD had credited some units toward Freddie Mac's Underserved Areas Housing Goal in 2002 that had been previously counted toward the goal in 2001. The units were associated with a large year-end Freddie Mac mortgage purchase transaction in 2002. Because HUD's regulations prohibit double counting, HUD has recalculated Freddie Mac's 2002 Underserved Areas Housing Goal performance. The recalculation also reflects correction of some coding errors discovered in HUD's recent review. With the recalculation, Freddie Mac fell slightly short of its 2002 Underserved Areas Housing Goal.

Table 6  
GSE Performance on the Underserved Areas Housing Goal, 1996-2003, and Goals for 2005-08

	1996	1997	1998	1999	2000	2001 <sup>1</sup>	2002 <sup>1</sup>	2003 <sup>1</sup>	2005-08 Goals		
									2005	2006	2007
Goal Levels:	21%	24%	24%	24%	24%	31%	31%	31%	37%	38%	39%
Fannie Mae Goal Performance											
Official	28.1%	28.8%	27.0%	26.8%	31.0%	32.6%	32.8%	32.1%			
2001-03 Baseline <sup>2</sup>	28.2%	28.9%	27.1%	26.8%	31.0%	30.4%	30.2%	29.2%			
With 2005 Assumptions (Counties) <sup>3</sup>				32.5%	38.2%	36.4%	35.7%	34.3%			
With 2005 Assumptions (Tracts) <sup>3</sup>				<b>31.6%</b>	<b>37.5%</b>	<b>35.7%</b>	<b>35.0%</b>	<b>34.1%</b>			
Freddie Mac Goal Performance											
Official	25.0%	26.3%	26.1%	27.5%	29.2%	31.7%	31.0% <sup>4</sup>	32.7%			
2001-03 Baseline <sup>2</sup>	25.0%	26.3%	26.1%	27.6%	29.2%	28.2%	28.0%	27.7%			
With 2005 Assumptions (Counties) <sup>3</sup>				32.4%	34.8%	33.3%	33.1%	31.6%			
With 2005 Assumptions (Tracts) <sup>3</sup>				<b>31.6%</b>	<b>34.1%</b>	<b>32.5%</b>	<b>32.4%</b>	<b>31.7%</b>			

<sup>1</sup> Goal level and official performance in 2001-03 are not directly comparable with goal level and performance in 1996-2000, because the goal performance counting rules for 2001-03 differ from those that were in effect for 1996-2000, as discussed in the text. Goal performance is based on official HUD results. Freddie Mac's goal performance in 2002 has been revised due to the double-counting of loans in 2001 and 2002 and correction of coding errors, as discussed in the text.

<sup>2</sup> "2001-03 Baseline" represents performance under current counting rules (which exclude bonus points and Freddie Mac temporary adjustment factor), with 1990 census data used to determine underserved areas; census tract boundaries as of the 1990 census; and metropolitan area boundaries prior to their re-specification by the Office of Management and Budget in June, 2003.

<sup>3</sup> "2005 Assumptions (Counties)" represents performance under current counting rules with 2000 census data used to determine underserved areas; census tract boundaries as of the 2000 census; and the Office of Management and Budget's specification of metropolitan area boundaries as of June, 2003. "2005 Assumptions (Tracts)" incorporates the traditional effects of using tracts rather than counties to define non-metropolitan underserved areas. These figures, also shown in Appendix B.7b, do not adjust performance for the revised treatment of missing data provided in this final rule.

<sup>4</sup> Freddie Mac's performance on this goal in 2002 was slightly short of the 31% goal level.

Based on the counting rules in effect at that time, as shown under “official performance” for 1996–2000 in Table 6, Underserved Areas Housing Goal performance for Fannie Mae generally fluctuated between 27 and 29 percent over the 1996–1999 period, before rising to a peak of 31.0 percent in 2000. Freddie Mac’s performance started at a lower level, but then increased in several steps, from 25–26 percent in 1996–1998, to 27.5 percent in 1999, and a record level of 29.2 percent in 2000. Freddie Mac’s performance in 1999 was the only year prior to 2001 in which it exceeded Fannie Mae’s performance on this Goal.

Based on counting rules in effect for 2001–2003, including the bonus points and the TAF, as shown under “official performance” in Table 6, Underserved Areas Housing Goal performance for Fannie Mae was 32.6 percent in 2001, 32.8 percent in 2002, and 32.1 percent in 2003. Performance for Freddie Mac was 31.7 percent in 2001, slightly less than 31.0 percent in 2002, and 32.7 percent in 2003.

Immediately beneath the official Underserved Areas Housing Goal performance percentages in Table 6 are figures showing the GSEs’ purchase percentages under this Goal on a consistent basis for the entire 1996–2003 period. The assumptions used were the counting rules established in HUD’s Housing Goals 2000 final rule, except that bonus points and the Freddie Mac TAF (which terminated at the end of 2003) are not applied. These figures are termed the “2001–2003 baseline” assumptions. For 1996–2000 these figures differ from the official performance figures because they incorporate the revised counting procedures, which were not reflected in the official performance figures at that time. For 2001–2003 both sets of figures incorporate the revised counting procedures, but the baseline does not incorporate the bonus points and Freddie Mac TAF.

In terms of the 2001–2003 baseline measure, both Fannie Mae and Freddie Mac’s Underserved Areas Housing Goal performance reached its maximum in 2000 (Fannie Mae at 31.0 percent and Freddie Mac at 29.2 percent) before declining somewhat over the 2001–2003 period. Both GSEs’ baseline performance in 2001–2003 exceeded the level attained in 1999.

Overall, both GSEs’ official performance exceeded their Underserved Areas Housing Goal by significant margins in 1996–1999, and by wide margins in 2000. New, higher Goals were established for 2001–2003, and despite somewhat lower

performance than the level attained in 2000 (largely due to the 2001–2003 refinancing wave), both GSEs’ performance exceeded the new Goal levels in 2001 and 2003; Fannie Mae also exceeded its goal in 2002, while Freddie Mac fell slightly short.

Appendix B to this rule includes a comprehensive analysis of the GSEs’ performance in funding mortgages for single-family-owner properties in underserved areas. (The data reported there are based on 2000 Census geography, which produces underserved area figures slightly over five percentage points higher than 1990-based geography.) Both GSEs have lagged the market in funding properties located in underserved neighborhoods. Between 1999 and 2003, 28.3 percent of Freddie Mac’s purchases of home loans financed properties in underserved neighborhoods, as did 30.0 percent of Fannie Mae’s purchases—compared with 31.4 percent of home purchase loans originated in the conventional conforming market (excluding B&C loans). Thus, Freddie Mac performed at 90 percent of the market level, while Fannie Mae performed at 96 percent of the market level. In 2003, underserved areas accounted for 29.0 percent of Freddie Mac’s purchases, 32.0 percent of Fannie Mae’s purchases, and 32.5 percent of market originations.

In evaluating the GSEs’ past performance, it should be noted that while borrowers in underserved metropolitan areas tend to have much lower incomes than borrowers in other areas, this does not mean that GSE mortgage purchases in underserved areas must necessarily be mortgages on housing for lower income families. Between 1999 and 2001, housing for above median-income households accounted for nearly 60 percent of the single-family owner-occupied mortgages that the GSEs purchased in underserved areas.

Beneath the 2001–2003 baseline figures in Table 6 are two additional rows of figures designated “2005 Assumptions.” These figures show the effects of applying 2000 census data and the new specification of MSAs released by OMB in 2003 to the identification of underserved areas for purposes of measuring historical GSE goal performance. The second of the two rows also incorporates the effects of the Department’s proposed change from counties to census tracts as the basis for identifying underserved areas outside of metropolitan areas beginning in 2005.

HUD’s determination of underserved areas for purposes of computing the GSEs’ performance on the Underserved Areas Housing Goal has, through 2003,

been based on area median incomes and area minority percentages from the 1990 Census. HUD applied the existing numerical thresholds for minority percentages and median incomes to 2000 Census data and ascertained that the proportion of underserved census tracts and the proportion of housing units in underserved census tracts in metropolitan areas both have increased significantly from 1990 levels: from 47.6 percent to 51.3 percent of census tracts underserved and from 44.3 percent to 48.7 percent of population in underserved census tracts (including the effects of the 2003 re-specification of Metropolitan Statistical Areas).

Comparable shifts at the county level in non-metropolitan areas were found to be of much smaller magnitude. Further, HUD estimated the spatial distribution of GSE mortgage purchases across metropolitan census tracts and non-metropolitan counties for recent years. The findings were that for 2000, 2001, 2002, and 2003, Fannie Mae’s performance figures are an estimated 7.2 percentage points, 6.0 percentage points, 5.5 percentage points, and 5.1 percentage points higher in terms of 2000 Census geography than with 1990 Census geography. The corresponding figures for Freddie Mac are 5.6 percentage points, 5.1 percentage points, 5.1 percentage points, and 3.9 percentage points larger, respectively.

With a further shift to tract-based definitions, the figures for Fannie Mae are reduced by 0.7 percentage point in 2000, 2001, and 2002, and for Freddie Mac by 0.7, 0.8, and 0.7 percentage point, respectively. The differences between county-based performance and tract-based performance were much smaller in 2003, with the latter falling below the former by only 0.2 percentage point for Fannie Mae and exceeding the former by 0.1 percentage point for Freddie Mac last year. As previously noted in the discussion of the Low- and Moderate-Income Housing Goals, the smaller differences between these two approaches in 2003 than in 2000–2002 may be due to the need to apply estimation techniques in 2000–2002 but not in 2003.

#### c. Underserved Areas Home Purchase Subgoal

The Department believes the GSEs can play a leadership role in underserved markets. To facilitate this leadership, the Department is establishing a Subgoal of 32 percent for each GSE’s acquisitions of home purchase mortgages on properties located in the underserved census tracts of metropolitan areas for 2005, rising to 33 percent in 2006 and 2007, and 34

percent in 2008. The purpose of this Subgoal is to encourage the GSEs to improve their purchases of mortgages for homeownership in underserved areas, thus providing additional credit and capital for neighborhoods that historically have not been adequately served. As discussed in Appendix A to this rule, the GSEs have the ability to lead the primary market for single-family-owner loans, which is their "bread-and-butter" business. Both GSEs have been dominant players in the home purchase market for years, funding 61 percent of the single-family-owner mortgages financed between 1999 and 2002. Through their many new product offerings and their various partnership initiatives, the GSEs have shown that they have the capacity to operate in underserved neighborhoods.

Even though they have the ability to lead the market, they have not done so, as both GSEs have lagged behind the primary market in serving underserved areas. As shown in Table 7, underserved areas (based on 2000 Census geography) accounted for 29.4 percent of Freddie Mac's purchases of home purchase mortgages in 2003, 32.0 percent of Fannie Mae's purchases, and 32.5 percent of market originations.<sup>16</sup> The

<sup>16</sup> HUD will begin defining underserved areas based on 2000 Census geography and new OMB definitions of metropolitan areas in 2005, the first year of the proposed rule. As explained in Appendix B of the proposed GSE Rule, the 2000-based definition of underserved areas includes 5,372 more census tracts in metropolitan areas than the 1990-based definition, which means the GSE-market comparisons had to be updated to incorporate tract designations from the 2000 Census. Therefore, for the years 1999, 2000, 2001,

following points can be made about the data presented in Table 7 regarding the underserved areas subgoal:

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and 2002, HUD used various apportionment techniques to re-allocate 1990-based GSE and HMDA data into census tracts as defined by the 2000 Census. (Since 2003 HMDA and GSE data were gathered in terms of 2000 Census geography, no apportionment was required for that year.) Switching to the 2000-based tracts increases the underserved area share of market originations by about five percentage points. Between 1999 and 2002, 30.3 percent of mortgage originations (without B&C loans) were originated in underserved tracts based on 2000 geography, compared with 25.2 percent based on 1990 geography. As shown in Table B.8 of Appendix B of this Final Rule, the underserved areas share of each GSE's purchases also rises by approximately five percentage points. Thus, conclusions about the GSEs' performance relative to the market are similar whether the analysis is conducted in terms of 2000 Census geography or 1990 Census geography.

**Table 7**  
**Underserved Areas Home Purchase Subgoals**

Subgoals Targets	2005	2006	2007	2008
	32%	33%	33%	34%
Subgoal Qualifying Mortgage Purchases <sup>1</sup>				
Underserved Areas	Fannie Mae	Freddie Mac	Conventional Market W/O B&C	Conforming Market <sup>2</sup> and LT \$15,000 Market W/O
	25.3%	25.6%	30.2%	29.8%
1999				
2000	29.0%	27.3%	31.7%	31.3%
2001	29.8%	27.3%	30.7%	30.3%
2002	32.3%	31.7%	31.8%	30.9%
2003	32.0%	29.0%	32.5%	32.2%
<b>Weighted Average</b>				
1999-2003	30.0%	28.3%	31.4%	31.0%
2001-2003	31.4%	29.4%	31.7%	31.2%
<b>Unweighted Average</b>				
1999-2003	29.7%	28.2%	31.4%	30.9%
2001-2003	31.4%	29.3%	31.7%	31.1%
2002-2003	32.2%	30.4%	32.2%	31.6%

<sup>1</sup> Based on counting rules for 2005-08, defined using 2000 Census data and geography, including metropolitan areas as defined by OMB on June 30, 2003. Subgoals apply to metropolitan areas only. See text for definition of subgoal-qualifying mortgages.

<sup>2</sup> Conventional conforming market for home purchase mortgages in metropolitan areas. Second column excludes mortgages with principal balance less than \$15,000.

*Underserved Areas Subgoals Compared With Market.* The 32-percent subgoal for the first year (2005) is approximately one percentage point above 1999–2003 and 2001–2003 average market performance (based on the market defined without B&C and small loans) and approximately at the 2002–2003 average market performance and the previous peak market performance. The 33-percent subgoal for 2006 and 2007 would add one percentage point to these comparisons, while the 34-percent subgoal for 2008 would add two percentage points. For example, the 34-percent subgoal is approximately three percentage points above both 1999–2003 and 2001–2003 average market performance, 1.8 percent (market without B&C loans) to 2.4 percent (market without both B&C and small loans) above 2002–2003 average market performance, and 1.5 percent (market without B&C loans) to 1.8 percent (market without both B&C and small loans) the market's previous peak performance in 2003.

*Underserved Areas Subgoals Compared With Past Freddie Mac Performance.* To reach the 32-percent 2005 subgoal, Freddie Mac would have to improve its performance by 2.7 percentage points over its 2001–2003 average underserved areas performance of 29.3 percent, by 1.6 percentage points over its 2002–2003 average underserved areas performance of 30.4 percent, and by 0.3 percent over its previous peak performance of 31.7 percent in 2002. To reach the 34-percent subgoal, Freddie Mac would have to improve its performance by 3.6 percentage points over its 2002–2003 average underserved areas performance, and by 2.3 percent over its previous peak performance. As noted in Table 7, Freddie Mac's performance jumped from 27.3 percent in 2001 to 31.7 percent in 2002, only to fall back to 29.0 percent in 2003. Thus, the 32-percent subgoal for 2005 is three percentage points above Freddie Mac's most recent experience (29.0 percent). However, as noted above, Freddie Mac's 31.7-percent performance in 2002 is only 0.3 percentage points below the 32-percent subgoal for 2005.

*Underserved Areas Subgoals Compared With Past Fannie Mae Performance.* To reach the 32-percent 2005 subgoal, Fannie Mae would have to improve its performance by 0.6 percentage points over its 2001–2003 average underserved areas performance of 31.4 percent; Fannie Mae would meet the 32-percent subgoal based on its 2002–2003 average underserved areas performance of 32.2 percent and its previous peak underserved areas performance of 32.3 percent in 2002. To reach the 34-percent subgoal, Fannie Mae would have to improve its performance by 2.6 percent over its 2001–2003 average performance, by 1.8 percentage points over its 2002–2003 average performance, and by 1.7 percent over its previous peak performance of 32.3 percent in 2003.

As with the other two home purchase subgoals, the underserved areas subgoal targets will be more challenging for Freddie Mac than Fannie Mae, particularly given Freddie Mac's low performance (29.0 percent) during the most recent year (2003). Again, the type of improvement needed to meet the new underserved areas subgoal targets was demonstrated by Fannie Mae during 2001–2003, as Fannie Mae increased its underserved areas purchases from 29.0 percent of its single-family-owner business in 2000 to approximately 32 percent in both 2002 and 2003. As noted above for the low-mod subgoals, staged increases in the underserved areas subgoal enable the GSEs to obtain their leadership position by gaining experience as they improve and move toward the new higher subgoal targets.

The type of improvement needed to meet this new underserved area subgoal was demonstrated by Fannie Mae during 2001 and 2002. During 2001, underserved area loans declined as a percentage of primary market originations (from 31.7 to 30.7 percent), but they increased as a percentage of Fannie Mae's purchases (from 29.0 to 29.8 percent); and during 2002, they increased further as a percentage of Fannie Mae's purchases (from 29.8 to 32.3 percent), placing Fannie Mae at the market level.

Section 4.b. above of this preamble and Section I.4 of Appendix B to this rule discuss the reasons why the Department is establishing a Subgoal for home purchase mortgages in underserved areas, namely: (1) the GSEs have the resources and the ability to lead the market in providing funding in underserved neighborhoods; (2) the GSEs lag the underserved areas market, even though they have the ability to lead; (3) troublesome disparities in our housing and mortgage markets indicate a continuing need for increased GSE activity; and (4) there are ample opportunities for the GSEs to improve their underserved area performance in the home purchase market.

Although single-family owner-occupied mortgages are the GSEs' principal line of business, the GSEs have lagged behind the primary market in financing properties in underserved areas. For the foregoing reasons, HUD believes that the GSEs can do more to raise the share of their home loan purchases in underserved areas. This can be accomplished by building on efforts that the GSEs have already started, including their new affordable lending products, their many partnership efforts, their outreach to inner city neighborhoods, their incorporation of greater flexibility into

their underwriting guidelines, and their purchases of seasoned CRA loans.

A wide variety of quantitative and qualitative indicators demonstrate that the GSEs have the resources and financial strength to improve their affordable lending performance enough to lead the market in underserved areas.

#### d. Summary of Comments

The Department received no comments that specifically addressed the level of the Underserved Areas Goal. The majority of commenters that offered opinions on the level of the housing goals focused on the high year (2008) of the Low- and Moderate-Income Goal. Where commenters did mention the Underserved Area Goal, their remarks were in the context of better targeting through changes in the definition of underserved areas. HUD also received no comments specific to the Underserved Area Home Purchase Subgoal. Both Fannie Mae and Freddie Mac commented on the level of the Underserved Area Goal. Fannie Mae stated that its replication of HUD's market sizing assumptions did not justify an Underserved Area Goal of 38 or 40 percent. For example, Fannie Mae noted that in reaching a goal level of 40 percent, HUD relied on the most unlikely owner-occupied underserved share of 30 percent, a level reached only once in the past 11 years. With respect to the Underserved Area Subgoal, Fannie Mae stated generally that subgoals risk unintended consequences and that HUD has proposed subgoals in excess of the opportunity and business mix seen in the market. Freddie Mac commented in general that all the goals and subgoals were set beyond what the primary market is likely to originate. With respect to the underserved areas market share, Freddie Mac estimates that the core ranges are 3–4 percentage points below the upper limits of the Department's projected ranges.

#### e. HUD's Determination

The Underserved Areas Housing Goal established in this final rule is reasonable and appropriate having considered the factors set forth in FHEFSSA. For 2001–2003, HUD set the level of the housing goal conservatively, relative to the Department's market share estimates, in order to accommodate a variety of economic scenarios. Moreover, current examination of the gaps in the mortgage markets, along with the estimated size of the market available to the GSEs, demonstrate that the number of mortgages secured by housing in underserved areas is more than

sufficient for the GSEs to achieve the new goal.

Therefore, having considered all the statutory factors including housing needs, projected economic and demographic conditions for 2005 to 2008, the GSEs' past performance, the size of the market serving low- and moderate-income families, and the GSEs' ability to lead the market while maintaining a sound financial condition, HUD has determined that the annual goal for mortgage purchases qualifying under the Underserved Areas Housing Goal will be 37 percent for 2005, 38 percent for 2006 and 2007, and 39 percent for 2008.

Further, the Department is establishing a Subgoal of 32 percent for each GSE's acquisitions of home purchase mortgages on properties located in the underserved census tracts of metropolitan areas for 2005, rising to 33 percent in 2006 and 2007, and 34 percent in 2008. This reflects a reduction in the upper end of the market share range from 35 percent to 34 percent since HUD's publication of its proposed rule, resulting from changes in estimating market share as described at the end of Section 3.a. above, and in Section G of Appendix D to this rule.

The reasons for increasing the Underserved Areas Housing Goal are discussed in Sections a. and b. above, and for establishing a Home Purchase Subgoal at the stated levels in section c. While the GSEs have lagged the primary market in funding loans in underserved areas, they appear to have ample room to improve their performance in that market. A wide variety of quantitative and qualitative indicators demonstrate that the GSEs have the expertise, resources, and financial strength to

improve their low- and moderate-income lending performance, including lending for home purchases in underserved areas, and achieve the levels of the goals being established.

#### 7. Special Affordable Housing Goal, § 81.14

This section discusses the Department's consideration of the statutory factors in arriving at, and the comments received on, the new housing goal level for the Special Affordable Housing Goal, which targets mortgages on housing for very low-income families and low-income families in low-income areas. After consideration of these statutory factors and the comments received, this final rule establishes the goal for the percentage of dwelling units to be financed by each GSE's mortgage purchases at 22 percent in 2005, 23 percent in 2006, 25 percent in 2007, and 27 percent in 2008.

After analyzing the statutory factors, HUD has determined to establish: (a) a Goal of 22 percent for the percentage of the total number of dwelling units financed by each GSE's mortgage purchases that are for special affordable housing, affordable to very low-income families and families living in low-income areas for 2005, rising to 23 percent in 2006, 25 percent in 2007, and 27 percent in 2008; (b) a Subgoal of 17 percent of the total number of each GSE's purchases of home purchase mortgages in metropolitan areas that are for housing affordable to very low-income families and low-income families in low-income areas for 2005 and 2006, rising to 18 percent in 2007 and 2008; and (c) a Subgoal of 1 percent of each GSE's combined annual average mortgage purchases in 2000, 2001, and 2002, for each GSE's special affordable

mortgage purchases that are for multifamily housing in 2005–2008.

A short discussion of the statutory factors for establishing the Special Affordable Housing Goal follows. Additional information analyzing each of the statutory factors is provided in Appendix C, "Departmental Considerations to Establish the Special Affordable Housing Goal," and Appendix D, "Estimating the Size of the Conventional Conforming Market for each Housing Goal."

#### a. Market Estimate for the Special Affordable Housing Goal

The Department estimates that dwelling units serving very low-income families and low-income families living in low-income areas will account for 23–27 percent of total units financed in the overall conventional conforming mortgage market during the period 2005 through 2008. HUD has developed this range, rather than a point estimate, to account for the projected effects of different economic conditions that can reasonably be anticipated. HUD also estimates that the special affordable market averaged 28 percent between 1999 and 2002.

#### b. Past Performance of the GSEs under the Special Affordable Housing Goal

As discussed above, a number of changes in goal-counting procedures were adopted as part of HUD's Housing Goals 2000 final rule. Thus, it is necessary to provide information using several different measures in order to track changes in performance on the Special Affordable Housing Goal over the 1996–2003 period. These are shown in Table 8.<sup>17</sup>

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<sup>17</sup> The Freddie Mac 2002 figures in Table 8 differ from the corresponding figures in Table 5 in HUD's Proposed Rule. Subsequent to publication of the Proposed Rule, HUD discovered that HUD had credited some units toward Freddie Mac's Special Affordable Housing Goal in 2002 that had been previously counted toward the goal in 2001. The units were associated with a large year-end Freddie Mac mortgage purchase transaction in 2002. Because HUD's regulations prohibit double counting, HUD has recalculated Freddie Mac's 2002 Special Affordable Housing Goal performance. The recalculation also reflects correction of some coding errors discovered in HUD's recent review.

Table 8

## GSE Performance on the Special Affordable Housing Goal and Multifamily Subgoals, 1996-2003, and Goals for 2005-08

	1996	1997	1998	1999	2000	2001 <sup>1</sup>	2002 <sup>1</sup>	2003 <sup>1</sup>	2005-08 Goals		
									2005	2006	2007
Goal Levels:	12%	14%	14%	14%	14%	20%	20%	20%	22%	23%	25%
Fannie Mae Goal Performance											
Official	15.4%	17.0%	14.3%	17.6%	19.2%	21.6%	21.4%	21.2%			
2001-03 Baseline <sup>2</sup>	16.7%	19.3%	16.3%	18.5%	21.4%	20.2%	19.9%	19.3%			
With 2005 Assumptions <sup>3</sup>				18.6%	21.7%	20.1%	19.4%	20.8%			
Freddie Mac Goal Performance											
Official	14.0%	15.2%	15.9%	17.2%	20.7%	22.6%	20.4%	21.4%			
2001-03 Baseline <sup>2</sup>	14.0%	15.2%	16.0%	17.4%	21.0%	19.3%	18.1%	17.8%			
With 2005 Assumptions <sup>3</sup>				17.4%	20.8%	19.1%	17.3%	19.0%			
Multifamily Subgoals (\$ billions):											
Fannie Mae Subgoal	\$1.29	\$1.29	\$1.29	\$1.29	\$1.29	\$2.85	\$2.85	\$2.85	\$5.49	\$5.49	\$5.49
Fannie Mae Performance	\$2.37	\$3.19	\$3.53	\$4.06	\$3.79	\$7.36	\$7.57	\$12.23			
Ratio, Performance/Subgoal	1.84	2.47	2.74	3.15	2.94	2.58	2.66	4.26			
Freddie Mac Subgoal	\$0.99	\$0.99	\$0.99	\$0.99	\$0.99	\$2.11	\$2.11	\$2.11	\$3.92	\$3.92	\$3.92
Freddie Mac Performance	\$1.06	\$1.21	\$2.69	\$2.26	\$2.40	\$4.65	\$5.22	\$8.79			
Ratio, Performance/Subgoal	1.07	1.22	2.72	2.28	2.42	2.20	2.47	4.17			

<sup>1</sup> Goal level and official performance in 2001-03 are not directly comparable with goal level and performance in 1996-2000, because the goal performance counting rules for 2001-03 differ from those that were in effect for 1996-2000, as discussed in the text. Goal performance is based on official HUD results. Multifamily subgoal figures for 2001-03 are comparable with figures for 1996-2000. Freddie Mac's goal performance in 2002 has been revised due to the double-counting of loans in 2001 and 2002 and correction of coding errors, as discussed in the text.

<sup>2</sup> "2001-03 Baseline" represents performance under current scoring rules (which exclude bonus points and Freddie Mac temporary adjustment factor), with 1990 census data used to determine low-income areas; no use of 2000 census data in estimating area median incomes; census tract boundaries as of the 1990 census and metropolitan area boundaries prior to their re-specification by the Office of Management and Budget in June, 2003.

<sup>3</sup> "2005 Assumptions" represents performance under current scoring rules with 2000 census data used to determine low-income areas and in estimating area median incomes; census tract boundaries as of the 2000 census; and the Office of Management and Budget's specification of metropolitan area boundaries as of June, 2003. These figures do not adjust performance for the revised treatment of missing data provided in this final rule.

Based on the counting rules in effect at that time, as shown under “official performance” for 1996–2000 in Table 8, Special Affordable Housing Goal performance for Fannie Mae generally fluctuated in the range between 14 and 17 percent over the 1996–1999 period, before rising to a peak of 19.2 percent in 2000. Freddie Mac’s performance started at a lower level, but then increased in several steps, from 14–16 percent in 1996–1998 to 17.2 percent in 1999, and to a record level of 20.7 percent in 2000. That was the only year prior to 2001 in which Freddie Mac’s performance exceeded Fannie Mae’s performance on the Special Affordable Housing Goal.

Based on counting rules in effect for 2001–2003, as shown under “official performance” in Table 8, Special Affordable Housing Goal performance for Fannie Mae was 21.6 percent in 2001, 21.4 percent in 2002, and 21.2 percent in 2003. Official performance for Freddie Mac was 22.6 percent in 2001, 20.4 percent in 2002, and 21.4 percent in 2003.

Immediately beneath the official Special Affordable Housing Goal performance percentages in Table 8 are figures showing the GSEs’ special affordable purchase percentages on a consistent basis for the entire 1996–2003 period. The assumptions used were the counting rules established in HUD’s Housing Goals 2000 final rule, except that bonus points and the Freddie Mac TAF (which were terminated at the end of 2003) are not applied. These are termed the “2001–2003 baseline” assumptions. In terms of this measure, both Fannie Mae and Freddie Mac’s special affordable performance reached its maximum in 2000 (Fannie Mae at 21.4, percent and Freddie Mac at 21.0 percent) before declining somewhat in 2001, and then declining further in 2002 and 2003. Both GSEs’ baseline performance in 2003 exceeded the level attained in 1999.

Overall, both GSEs’ performance exceeded HUD’s Special Affordable Housing Goals by significant margins in 1996–1999, and by wide margins in 2000. New, higher Goals were established for 2001–2003, and despite somewhat lower performance than the level attained in 2000 (largely due to the 2001–2003 refinance wave, as discussed under the Low- and Moderate-Income Housing Goal), both GSEs’ performance exceeded the new Goal levels in 2001–2003.

The Special Affordable Housing Goal is designed, in part, to ensure that the

GSEs maintain a consistent focus on serving the low- and very low-income portion of the housing market where housing needs are greatest. Appendices A and C to this rule use HMDA data and GSE loan-level data for home purchase mortgages on single-family owner-occupied properties in metropolitan areas to compare the GSEs’ performance in special affordable lending to the performance of depositories and other lenders in the conventional conforming market. There are two main findings with respect to the special affordable category.

*First*, Freddie Mac and Fannie Mae have historically lagged depositories and the overall market in providing mortgage funds for special affordable borrowers over periods, such as 1993–2003, 1996–2003, and 1999–2003. Between 1993 and 2003, 12.2 percent of Freddie Mac’s mortgage purchases were for special affordable borrowers, 13.3 percent of Fannie Mae’s purchases, 15.4 percent of loans originated by depositories, and 15.5 percent of loans originated in the conventional conforming market (without estimated B&C loans). During the period between 1999 and 2003, the GSEs’ performance was approximately 90 percent of the market’s special affordable loans accounted for 15.1 percent of Fannie Mae’s purchases, 14.5 percent of Freddie Mac’s purchases, and 16.2 percent of loans originated in the conforming market. (See Table 9, which is based on 2000 Census geography.)

*Second*, while both GSEs have improved their performance over the past few years, Fannie Mae has made more progress than Freddie Mac in erasing its gap with the market. During 2003, the special affordable share of Fannie Mae’s purchases was 17.7 percent, which was above the market share of 16.8 percent. In 2003, the special affordable share of Freddie Mac’s purchases was 16.2 percent.

Section G in Appendix A to this rule discusses the role of the GSEs both in the overall special affordable market and in the different segments (single-family owner, single-family rental, and multifamily rental) of the special affordable market. The GSEs’ special affordable purchases accounted for 41 percent of all special affordable owner and rental units that were financed in the conventional conforming market between 1999 and 2002. The GSEs’ 41-percent share of the special affordable market was below their 55-percent share of the overall market. Even in the owner market, where the GSEs account for 61 percent of the market, their share of the

special affordable market was only 52 percent. As noted above, Fannie Mae led the primary market in funding special affordable home loans during 2003. On the other hand, Freddie Mac continued to lag that market in 2003. The data indicate that there is room for Freddie Mac to improve its performance in purchasing affordable home loans at the lower-income end of the market.

The rental market (including both 1- to 4-family rental properties and multifamily rental properties) is especially important in the establishment of the Special Affordable Housing Goal for Fannie Mae and Freddie Mac because of the relatively high percentage of rental units meeting the Special Affordable Housing Goal. For example, between 1999 and 2002, 51 percent of units financed by Fannie Mae’s rental mortgage purchases met the Special Affordable Housing Goal, representing 46 percent of units counted toward the Special Affordable Housing Goal, during a period when rental units represented only 18 percent of its total purchase volume. For Freddie Mac, 50 percent of units financed by rental mortgage purchases met the Special Affordable Housing Goal, representing 41 percent of units counted toward the Special Affordable Housing Goal, during a period when rental units represented only 16 percent of its total purchase volume.

#### c. Special Affordable Home Purchase Subgoal

The Department believes the GSEs can play a leadership role in the special affordable market generally, and the home purchase special affordable market in particular. Thus, the Department is establishing a Subgoal of 17 percent for each GSE’s purchases of home purchase mortgages for special affordable housing located in metropolitan areas for 2005 and 2006, rising to 18 percent in 2007 and 2008.

The purpose of this Subgoal is to encourage the GSEs to improve their purchases of home purchase mortgages on special affordable housing, thus expanding homeownership opportunities for very-low-income borrowers and low-income borrowers in low-income areas, including minority first-time homebuyers who are expected to enter the housing market over the next few years. Table 9 provides information needed to compare the special affordable subgoal targets with past market and GSE performance.

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**Table 9**  
**Special Affordable Home Purchase Subgoals**

Subgoals Targets	2005	2006	2007	2008
	17%	17%	18%	18%
Subgoal Qualifying Mortgage Purchases <sup>1</sup>				
Special Affordable	Fannie Mae	Freddie Mac	Conventional Market	Conforming Market <sup>2</sup>
	12.5%	12.8%	W/O B&C	and LT \$15,000
	1999	12.8%	17.1%	16.6%
	2000	14.5%	16.8%	16.2%
	2001	13.9%	15.4%	15.1%
	2002	15.1%	15.4%	15.2%
2003	16.2%	16.8%	16.5%	
Weighted Average				
1999-2003	15.1%	14.5%	16.3%	15.9%
2001-2003	16.2%	15.0%	15.9%	15.6%
Unweighted Average				
1999-2003	14.8%	14.5%	16.3%	15.9%
2001-2003	16.1%	15.1%	15.9%	15.6%
2002-2003	16.8%	15.7%	16.1%	15.9%

<sup>1</sup> Based on counting rules for 2005-08, defined using 2000 Census Data and Geography, including metropolitan areas as defined by OMB on June, 30, 2003. Subgoals apply to metropolitan areas only. See text for definition of subgoal-qualifying mortgages.

<sup>2</sup> Conventional conforming market for home purchase mortgages in metropolitan areas. Second column excludes mortgages with principal balance less than \$15,000.

*Special Affordable Subgoals Compared With Market.* The 17-percent subgoal for the first year (2005) is approximately one percentage point above the 1999–2003, 2001–2003, and 2002–2003 average market performance. The 17-percent subgoal is at the previous peak market performance (the 1999, 2000, and 2003 markets without B&C loans were about 17 percent) or slightly below the previous peak market performance (based on 2003 market without both B&C and small loans). The 18-percent subgoal for 2007 and 2008 would add one percentage point to these figures. Thus, the 18-percent subgoal is approximately two percentage points above the 1999–2003, 2001–2003, and 2002–2003 average market performance of approximately 16 percent. The 18-percent subgoal is one percentage point above the previous peak market performance (the 1999, 2000, and 2003 markets without B&C loans were about 17 percent) or 1.5 percentage points above the previous peak market performance based on the 2003 market without both B&C and small loans.

*Special Affordable Subgoals Compared With Past Freddie Mac Performance.* To reach the 17-percent 2005 subgoal, Freddie Mac would have to improve its performance by 1.9 percentage points over its 2001–2003 average special affordable performance of 15.1 percent, by 1.3 percentage points over its 2002–2003 average special affordable performance of 15.7 percent, and by 0.8 percent over its previous peak performance of 16.2 percent in 2003. To reach the 18-percent subgoal, Freddie Mac would have to improve its performance by 2.9 percentage points over its 2001–2003 average special affordable performance, 2.3 percent over its 2002–2003 average performance, and by about 1.8 percent over its previous peak performance.

*Special Affordable Subgoals Compared With Past Fannie Mae Performance.* To reach the 17-percent 2005 subgoal, Fannie Mae would have to improve its performance by 0.9 percentage points over its 2001–2003 average special affordable performance of 16.1 percent; Fannie Mae would essentially meet the 17-percent subgoal based on its 2002–2003 average special affordable performance of 16.8 percent and would surpass the 17-percent subgoal based on its peak special affordable performance of 17.7 percent in 2003. To reach the 18-percent subgoal, Fannie Mae would have to improve its performance by 1.9 percent over its 2001–2003 average performance and by 1.2 percentage points over its 2002–2003 average performance; Fannie Mae would meet the 18-percent subgoal

based on its peak performance of 17.7 percent in 2003.

As with the low-mod and underserved areas subgoals, the special affordable subgoal targets will be more challenging for Freddie Mac than Fannie Mae. But, as with other goals, the type of improvement needed to meet the new special affordable subgoal targets was demonstrated by Fannie Mae during 2001–2003, as Fannie Mae increased its special affordable purchases from 13.4 percent of its single-family-owner business in 2000, to 15.8 percent in 2002, to 17.7 percent in 2003, as shown in Table 9. This subgoal is designed to encourage Fannie Mae and Freddie Mac to lead the special affordable market. As noted earlier, the approach taken is for the GSEs to obtain their leadership position by staged increases in the subgoals to enable the GSEs to gain experience as they improve and move toward the new higher subgoal targets.

The section above on considerations in establishing the Low- and Moderate-Income Home Purchase Subgoal and Section D of Appendix C to this rule further discuss reasons why the Department set the Subgoal for special affordable loans.

Both Fannie Mae and Freddie Mac questioned HUD's authority under FHEFSSA to establish any subgoals within the Special Affordable Housing Goal. The GSEs noted that both sections establishing the Low- and Moderate-Income and the Underserved Areas Housing Goals include language that HUD "may establish separate specific subgoals within the goal under this section and such subgoals shall not be enforceable \* \* \* ." No such language appears in the section establishing the Special Affordable Housing Goal. The GSEs asserted that this omission is an indication that Congress intended to prohibit HUD from establishing any subgoals within the Special Affordable Housing Goal.

HUD has also considered the GSEs' claim that HUD lacks the statutory authority to impose any subgoals within the Special Affordable Housing Goal. These same arguments were presented by the GSEs during HUD's 1995 rulemaking establishing the housing goals. (See Housing Goals 1995 proposed rule published on February 16, 1995 at 60 FR 9154, and the final rule published on December 1, 1995 at 60 FR 1846.)

At that time, HUD stated that the absence of a similar subgoal provision under the Special Affordable Housing Goal section "is not an indication that subgoals or subcategories within the overall goal are prohibited; rather, such

omission indicates that to the extent that subgoals or subcategories are promulgated for the Special Affordable Housing Goal, no bar exists to enforcing them." (60 FR 61860.) The 1995 Housing Goals final rule established an enforceable subgoal for multifamily mortgages within the Special Affordable Housing Goal; this subgoal has been in place each year since then. This final rule does not change this longstanding agency interpretation.

#### d. Special Affordable Housing Goal: Multifamily Subgoals

Based on the GSEs' past performance on the Special Affordable Multifamily Subgoals, and on the outlook for the multifamily mortgage market, HUD proposed that these Subgoals be retained for the 2005–2008 period.

Unlike the overall Goals, which are expressed in terms of minimum Goal-qualifying percentages of total units financed, these Subgoals for 2001–2003 and in prior years have been expressed in terms of minimum dollar volumes of Goal-qualifying multifamily mortgage purchases. Specifically, each GSE's special affordable multifamily Subgoal is currently equal to 1.0 percent of its average total (single-family plus multifamily) mortgage volume over the 1997–1999 period. Under the proposal, the GSEs' purchases of mortgages financing dwelling units in multifamily housing for calendar years 2005–2008 will be 1.0 percent of the GSEs' average annual dollar volume of mortgage purchases in the calendar years 2000, 2001, and 2002. The proposal would increase the subgoal levels by roughly 90 percent compared to their current levels. Specifically, Fannie Mae's total eligible multifamily mortgage purchase volume increased from \$4.6 billion in 1993 to \$12.5 billion in 1998, and then jumped sharply to \$18.7 billion in 2001, \$18.3 billion in 2002, and \$33.3 billion in 2003. As shown in Table 8, special affordable multifamily mortgage purchases followed a similar path, rising from \$1.7 billion in 1993 to \$3.5 billion in 1998 and \$4.1 billion in 1999, and also jumping sharply to \$7.4 billion in 2001, \$7.6 billion in 2002, and \$12.2 billion in 2003. As a result of its strong performance, Fannie Mae's purchases have been at least twice its minimum subgoal in every year since 1997—247 percent of the Subgoal in that year, 274 percent in 1998, 315 percent in 1999, 294 percent in 2000, and, under the new Subgoal level, 258 percent in 2001, 266 percent in 2002, and 426 percent in 2003.

Freddie Mac's total eligible multifamily mortgage purchase volume increased even more sharply, from \$0.2

billion in 1993 to \$6.6 billion in 1998, and then jumped further to \$11.8 billion in 2001, \$18.3 billion in 2002, and \$21.5 billion in 2003. As shown in Table 8, special affordable multifamily mortgage purchases followed a similar path, rising from \$0.1 billion in 1993 to \$2.7 billion in 1998, and also jumping sharply to \$4.6 billion in 2001, \$5.2 billion in 2002, and \$8.8 billion in 2003. As a result of its strong performance, Freddie Mac's purchases have also been at least twice its minimum Subgoal in every year since 1998—272 percent of the Subgoal in that year, 228 percent in 1999, 242 percent in 2000, and, under the new Subgoal level, 220 percent in 2001, 247 percent in 2002, and 417 percent in 2003.

The Special Affordable Multifamily Subgoals set forth in this final rule are reasonable and appropriate based on the Department's analysis of this market. The Department's decision to retain these Subgoals is based on HUD's analysis, which indicates that multifamily housing still serves the housing needs of lower-income families and families in low-income areas to a greater extent than single-family housing. By retaining the Special Affordable Multifamily Subgoal, the Department ensures that the GSEs continue their activity in this market, and that they achieve at least a minimum level of special affordable multifamily mortgage purchases that are affordable to lower-income families.

#### e. Summary of Comments

Comments regarding the Special Affordable Goal were received from numerous public advocacy groups and one trade association; however, only one public advocacy group commented on the level of the goal. The commenting group recommended that the 2004 Special Affordable Goal be maintained for the years 2005–2008.

No comments specific to the Special Affordable Home Purchase Subgoal were received from the public. Fannie Mae provided an analysis as part of its comments that illustrated, for the years 1999 through 2002, that the market did not perform up to the level of HUD's proposed Special Affordable Home Purchase Subgoal.

Regarding the Multifamily Special Affordable Subgoal, neither GSE objected to HUD's proposed subgoal levels for 2005–2008. One trade organization suggested that the subgoal has outlived its original purpose and should be discontinued. This organization stated that the subgoal was established to induce the GSEs to purchase multifamily loans at a time when heavy credit losses had caused

them to back away from this market, and that the situation had changed greatly since then. The organization stated that the overall goals now provided sufficient incentive for the GSEs to focus on multifamily mortgage purchases. One multifamily lender expressed concern that increasing the Multifamily Special Affordable Subgoal will push the GSEs to extend credit to unqualified borrowers with poor quality properties that should not be eligible for long-term, low-cost financing. However, other commenters, including multiple public advocacy groups and a local government official, recommended that HUD increase the level of this subgoal. Several commenters specifically recommended that HUD set this subgoal between 2.5 percent and 3 percent of the GSEs' purchases in preceding years. They noted that the GSEs have far exceeded the subgoal levels in recent years and said that a higher subgoal level is needed to promote additional multifamily lending.

#### f. HUD's Determination

HUD concludes that the Special Affordable Housing Goal established in this final rule is reasonable and appropriate having considered the factors set forth in FHEFSSA. Current examination of the gaps in the mortgage markets, along with the estimated size of the market available to the GSEs, demonstrates that the number of mortgages secured by special affordable housing is more than sufficient for the GSEs to achieve the new goal.

Therefore, having considered all the statutory factors including housing needs, projected economic and demographic conditions, the GSEs' past performance, the size of the market serving low- and moderate-income families, and the GSEs' ability to lead the market while maintaining a sound financial condition, HUD has determined that the Special Affordable Housing Goal will be 22 percent for 2005, 23 percent for 2006, 25 percent for 2007, and 27 percent for 2008. This reflects a reduction in the upper end of the market share range from 28 percent to 27 percent since HUD's publication of its proposed rule, resulting from changes in estimating market share as described at the end of section 3.a, above, and in Section H of Appendix D to this rule.

The reasons for increasing the Special Affordable Housing Goal are discussed above in this preamble. Since the GSEs have historically lagged the primary market in purchasing loans on owner and rental properties that qualify as special affordable, they have ample room to improve their performance in

that market. The GSEs' mortgage purchases between 1999 and 2002 accounted for 55 percent of the total (single-family and multifamily) conforming mortgage market, but they accounted for only 41 percent of the special affordable market. A wide variety of quantitative and qualitative indicators demonstrate that the GSEs have the expertise, resources, and financial strength to improve their special affordable lending performance and to close their gap with the market.

Further, the Department is establishing a Subgoal of 17 percent for each GSE's acquisitions of home purchase mortgages for special affordable housing in 2005 and 2006, rising to 18 percent in 2007 and 2008. The special affordable home purchase subgoal will ensure that Freddie Mac improves its performance enough not only to close its current gap with the primary market but also to place itself in a leadership position. The subgoal will also encourage Fannie Mae to improve further its current market-leading performance. A wide variety of quantitative and qualitative indicators demonstrate that the GSEs have the expertise, resources, and financial strength to improve their special affordable lending performance, including lending for home purchases for special affordable housing, and to achieve the levels of the subgoals being established.

Finally, the Department is establishing each GSE's Special Affordable Multifamily Subgoal at 1.0 percent of its average annual dollar volume of total (single-family and multifamily) mortgage purchases over the 2000–2002 period. In dollar terms, the level of the subgoal is \$5.49 billion per year in special affordable multifamily mortgage purchases for Fannie Mae and \$3.92 billion per year in special affordable multifamily mortgage purchases for Freddie Mac. These Subgoals would be less than the actual special affordable multifamily mortgage purchase volume in 2001–2003 for both GSEs. Thus, the Department believes that they would be feasible for the 2005–2008 period.

HUD believes that the proposed increase in the dollar level of the Special Affordable Multifamily Subgoal balances the need to promote GSE activity in this segment with the need to provide some protection in the event of a decline in overall mortgage market activity. Because this goal is set as a dollar amount rather than as a share of business, overall declines in residential mortgage lending would make this goal harder to achieve. Setting the subgoal level based on the GSEs' record

multifamily loan purchases during 2000–2002 sets an appropriately high level for the next several years, in the Department's view. In recent years Fannie Mae and Freddie Mac have each purchased multifamily mortgages in at least twice the subgoal amount. The increase in that subgoal dollar level should serve to provide a more meaningful floor to the level of multifamily lending during the 2005–2008 period.

#### 8. Missing Data/No-Doc Loans

*Overview.* Accurate measurement of the GSEs' performance under the three Housing Goals depends on the completeness of data on borrower income (or, in the case of non-owner-occupied units, the rent) and property location. With respect to property location data, there was a less than one percent incidence of missing or incomplete geographical data between 2000 and 2002 for mortgages purchased by the GSEs. The incidence of missing borrower income data has been greater—on the order of several percent each year.

One reason for the increase in missing income data is the market's recent increased use of mortgages, commonly called low documentation (Low Doc) and no documentation (No Doc) loans. These loans do not require the borrower to provide income information. In some cases, the borrower provides information on assets but not income because of circumstances that make assets easier to document. In other instances, mortgages are originated entirely on the basis of a credit report, property appraisal, and cash for the downpayment. These mortgages typically require relatively large downpayments and may also require a higher interest rate than fully documented mortgages.

The Housing Goals 2000 Final Rule provided that the GSEs may exclude from the denominator owner-occupied units which lack mortgagor income data and which are located in low- or moderate-income census tracts, *i.e.*, tracts whose median income is no greater than the median income of the metropolitan area, or for properties located outside of metropolitan areas, the larger of the median incomes of the county or the statewide non-metropolitan area (see 24 CFR 81.15(d)).<sup>18</sup>

In view of the increasing use of loans made without obtaining income information from the borrower, there is a question whether HUD's existing counting rules for missing-data situations are adequately reliable and create no more than a negligible statistical bias in the GSEs' Housing Goals performance figures relative to the values that they would have if complete income data could be obtained, and whether a more precise method for imputing incomes could be employed. For this reason, HUD requested comments from the public about the desirability and feasibility of implementing a standard econometrically based method for imputing the income distribution of mortgages purchased by each GSE that lack income data, based on known characteristics of the loan and the census tract.

*Summary of Comments.* Fannie Mae supported expanding affordability estimation to single-family rental and owner-occupied goal performance calculations and favored a more complex econometrically based affordability estimation methodology. For owner-occupied units Fannie Mae suggested a method based on the probability of mortgages/units qualifying for a goal based on census tract location. Fannie Mae stated that the multifamily affordability estimation methodology could also be applied to single-family rental units. Fannie Mae commented that if HUD were to adopt an econometrically based methodology, no limit should be placed on its implementation. With the current methodology, Fannie Mae requested that the limit for rental units be increased to 10 percent of total rental unit acquisitions.

Freddie Mac commented that HUD should adopt a simpler approach to missing data. For example, HUD should allow the GSEs to remove units with missing incomes from the calculation of the housing goals. Freddie Mac reasoned that the market numbers used in establishing the Housing Goals omit missing data and that omitting missing data from a GSE's performance would be consistent. Also, Freddie Mac stated that it historically has had a lower missing data rate than the market and that it has sufficient business related incentives to reduce missing data. Freddie Mac commented that any limits on adjustments for missing data should be related to overall missing data rates in the market, estimation parameters should be available at the beginning of the performance year, and estimation procedures should be simple and straightforward to implement.

Several other organizations endorsed a standardized procedure for estimating affordability for those units missing rent or income data, including an econometrically based methodology. Two commenters stated that HUD should require only actual data for determining whether a unit is affordable or not. In addition, some commenters strongly recommended that HUD disallow goals credit for all no-documentation subprime loans because such loans are likely to be predatory.

*HUD's Determination.* Having considered the comments received, HUD has determined that permitting some level of estimation for affordability data is reasonable and consistent with statutory intent that the GSEs serve the affordable housing needs of families even if actual data are not available. With regard to some commenters' objections that HUD should not permit the use of estimated data for—or even allow goals credit for—any loans that were underwritten for approval without borrower income data due to the potential for these loans to have predatory features, the Department does not find that these loans are inherently predatory in nature. Also, both GSEs have publicly announced that they will not finance any loans with predatory features, and the Department expects that they will continue to vigorously enforce these policies. Accordingly, this final rule implements several changes to the treatment of missing data. The first change amends § 81.15(d) of the General Requirements to provide an alternative treatment for single-family owner-occupied units where the mortgagor's income is missing. As provided in § 81.15(d), the GSEs may continue to exclude such units from the denominator as well as the numerator when they are located in census tracts with median income less than or equal to area median income according to the most recent census, up to a ceiling of one percent of total eligible units. Purchases in excess of the ceiling will be included in the denominator and excluded from the numerator if they are missing data.

However, in lieu of using this procedure, HUD is making available to the GSEs in § 81.15(d) an alternative method for missing income treatment that provides the GSEs with the ability to apply a HUD-approved affordability estimation methodology to all single-family owner-occupied units with missing borrower income data up to a specified maximum. This alternative provision specifies an approach that recognizes the distribution of borrower incomes within census tracts in determining how to treat loans with

<sup>18</sup> For rental units, the 2000 Housing Goals Final Rule also established counting rules that allow the GSEs to estimate rents or exclude units from the denominator when rent data are missing. See 24 CFR 81.15(e)(6)(i) on the rules applicable to multifamily units and 24 CFR 81.15(e)(6)(ii) on the rules for single-family rental units.

missing income data. Goal-qualifying units, by census tract, are estimated by multiplying the number of single-family owner-occupied units with missing borrower income information in properties securing mortgages purchased by the GSE, by the percentage of all single-family owner-occupied units from originations that would count toward achievement of the goal, as determined by HUD based on the most recent HMDA data available, for each census tract where the GSE acquired mortgage units. In establishing the maximum number of units where borrower income may be estimated under this alternative provision, HUD will apply two factors. The first of these is the rate of missing borrower income data for each census tract. This is calculated using HMDA data for the most recent years for which comparable data are available. The second factor is the number of single-family owner-occupied units purchased by a GSE during the performance year, by census tract. The maximum is calculated by multiplying the HMDA percentage of missing income data by the number of units that a GSE purchased in each tract. This number is summed up for all tracts to obtain the overall nationwide maximum for that GSE. HUD will provide each GSE with a dataset containing applicable tract-based HMDA missing income rates prior to the start of each year. The GSEs may choose which provision of § 81.15(d) they will use in any year. However, they may not combine the options available under this provision. If the maximum on missing single-family owner-occupied unit incomes is exceeded, the estimated goal-qualifying units will be adjusted by the ratio of the maximum amount divided by the total number of units with missing income information. Under each provision of § 81.15(d), units in excess of the specified maximum as well as units where affordability information is not available will remain in the denominator when calculating goal performance.

HUD is also in this final rule revising § 81.15(e)(6) to change the current maximum on the use of HUD-approved multifamily rent estimation data from 5 percent to 10 percent. In analyzing the GSEs' multifamily purchases for the past several years, HUD has determined that this change is statistically insignificant and will serve to promote further the financing of rental units that would otherwise be eligible for credit under the Housing Goals. In this final rule, HUD is also specifying a methodology that may be used to estimate affordability data for

multifamily properties with missing rent data. This methodology is the same methodology that has been used in past years to estimate affordability data for multifamily properties with missing rent data.

With regard to single-family one-to-four unit rental properties financed with loans that are missing affordability data, the Department finds that a lack of data should not act as a disincentive for the GSEs to serve markets that historically are important sources of affordable housing. Under HUD's 2000 Rule, § 81.15(e)(6)(ii) permits the GSEs to exclude these units from both the numerator and the denominator when neither income nor rental data are available. While this provision does not penalize the GSEs for financing these properties by requiring that they be counted in the denominator towards goal calculation, it also does not allow them to obtain Housing Goals credit for financing mortgages that tend disproportionately to serve affordable housing. In this final rule, HUD is retaining the exclusion provision at § 81.15(e)(6)(ii) but is also adding an alternative provision that will permit the use of the same estimation methodology now used for multifamily loans with missing rent data. However, HUD is imposing separate maximum rates for the new provision as follows: a 5 percent maximum on unseasoned single-family rental units originated in the current year and a 20 percent maximum for seasoned loan units, that is, for loans that were originated more than 365 days prior to the date of acquisition by the GSE. HUD recognizes the greater difficulty of obtaining rent information on units from mortgages originated a year or more prior to acquisition by the GSE. Therefore, HUD is allowing the higher maximum on affordability estimation for these units. As with the estimating provisions permitted under § 81.15(d), the GSEs may use only one of the provisions permitted under § 81.15(e)(6)(ii) in any year.

In addition to the changes described herein, HUD is adding a provision to §§ 81.15(d)(2)(i), 81.15(e)(6)(i) and (ii) that permits the use of such other data source or methodology as may be approved by HUD. HUD is also clarifying that owner occupied units that exceed the maximum established under § 81.15(d)(2) for using any estimation methodology will remain in the denominator of the respective goal calculation.

#### 9. Double Counting of Seasoned Mortgages

In addition to the preceding changes being made at this final rule stage, HUD is making a technical change to § 81.16(c)(6) for purposes of clarity. Paragraph (c)(6) addresses the treatment of seasoned mortgages. The paragraph, as currently codified, is a long one-sentence paragraph. HUD believes that dividing this paragraph into two subparagraphs would improve comprehensibility and clarity. This change is intended to clarify the restriction on double counting of seasoned mortgages in § 81.16(c)(6), *i.e.*, the restriction that prohibits the counting of a GSE's purchase of a seasoned mortgage toward a goal where such mortgage has already been counted by the GSE toward the goal. This change makes clear that the restriction applies to all seasoned mortgages, regardless of whether any other counting rules under § 81.16(c) also apply. Section 81.16(c)(6) in this final rule reflects this technical change.

#### 10. Bulk Purchases/Counting of Seasoned Loans

*Overview.* In its May 3, 2004, proposed rule, HUD sought comment on whether its current definition of a "mortgage purchase" should be revised to ensure that transactions, especially large transactions, are appropriately counted under the law and in accordance with the purposes of FHEFSSA and the GSEs' charter acts. HUD also sought comment on whether it should amend its counting rules at 24 CFR 81.15 and 81.16 to ensure that the GSEs' large-scale transactions further the requirements and purposes of the Housing Goals.

For example, HUD asked if commenters believe the current counting rules are specific enough to determine which seasoned mortgage transactions, including large-scale transactions, are substantially equivalent to mortgage purchases. HUD sought these comments primarily in response to certain large-scale transactions of seasoned loans undertaken by both GSEs in late 2003 for the purpose of meeting the 2003 Housing Goals. HUD questioned whether such transactions furthered the purposes of FHEFSSA, especially since the transactions, including a transaction between Freddie Mac and Washington Mutual Bank (WaMu), contained an option for dissolution in the following year. HUD sought public comment on its counting rules and definitions to ascertain the effect of the GSEs' bulk purchases, including those with special

terms or conditions, on the market and on affordable housing.

*Summary of Comments.* HUD received several suggestions for revising its current definitions and counting rules. A trade association commented that HUD should specify the definition of mortgage purchase so as not to count transactions that are goals-oriented in form but not in substance. Some organizations commented that seasoned loans should be excluded from counting towards the goals altogether because they do not directly fund new housing supply. Likewise, some commenters believed that these transactions are contrary to the Charter requirement that the GSEs provide assistance to the secondary market on an on-going basis.

One policy group asked that HUD exclude loans with recourse clauses because these purchases do not alleviate risk from the market. Other commenters took the opportunity to request that the definitions and counting rules more closely match CRA loan definitions. These commenters did not suggest specific regulatory language for the definitions.

HUD also received comments that supported counting bulk purchases that occur late in the year towards the goals. One trade association described the efficiencies gained from large-scale transactions. For example, the market for multifamily units is large and fragmented, and seasoned portfolio transactions are an efficient means for the GSEs to acquire smaller loans in the under 50-unit segment of the market. Some commenters cautioned that changing the definition of mortgage purchase or the counting rules to clarify the treatment of large-scale seasoned mortgage transactions could have negative unintended consequences.

The GSEs responded to this issue with detailed comments. Fannie Mae stated that every mortgage purchase, whether executed through flow, large or seasoned transactions, contributes to its housing mission, and therefore, HUD should not change the qualification of mortgage purchases either for the size of the transaction or for the amount of seasoning involved. Fannie Mae also stated that large-scale mortgage purchases lower transactions costs for both the buyers and sellers of mortgages. Some lenders offer to sell the GSEs mortgages on a flow basis, but others prefer to bundle mortgages together and sell to the GSEs from their portfolios. Bulk transactions also serve the business needs of lenders who do not have a direct relationship with Fannie Mae. Fannie Mae said that two-thirds of its bulk purchases between 2001 and 2003 were not for seasoned loans.

Fannie Mae characterized the purchase of seasoned loans as an important component of the liquidity of current mortgages. Knowing that there is a ready market allows financial institutions to hold some of their assets in the form of mortgages, and affords them the opportunity to sell these mortgages later to manage liquidity, improve profitability, strengthen their capital position, and manage certain risks.

In addition to the market benefits of seasoned mortgages, Fannie Mae also discussed the practical relationship of seasoned loan treatment and goals performance. The GSEs need bulk purchases of seasoned loans to meet the goals in years when the mix of business in the primary market deviates from the business mix anticipated at the time the goals were set. Fannie Mae pointed out that HUD cited late-year purchases of seasoned loans in the proposed rule as a useful method to meet the goals when market conditions change unexpectedly. Fannie Mae also discussed the attributes of dissolvable securities, stating that lenders sometimes request the option to dissolve securities swapped with the GSEs. Fannie Mae said that dissolution options are common terms in the marketplace because dissolution options grant lenders greater control over their balance sheets, capital position, and other financial concerns. Fannie Mae indicated that lenders request these options because they obtain more favorable rates and can make more loans.

Freddie Mac made many of the same points about bulk purchases of seasoned purchases as Fannie Mae and also discussed its recent bulk transaction with WaMu. For example, Freddie Mac commented that bulk purchases and dissolution options are common industry practices. Freddie Mac also stated that counting seasoned loans increased the value and liquidity of current loans. Knowledge that the GSEs stand ready to purchase mortgages under all market conditions gives other investors greater confidence because they have a viable exit strategy when providing funds to the real estate market.

Freddie Mac indicated that bulk purchases are an essential means of achieving the goals when market conditions take an unexpected turn, such as the conditions leading to its transaction with WaMu in 2003. Freddie Mac pointed out that, unlike FHA, which can manage its business to the cap on insurance commitments set annually by Congress, Freddie Mac instead must respond to a dynamic market in which the nature and magnitude of loan originations are

volatile. In real time, it is extremely difficult to predict the volume and “mix” or proportion of goals-eligible mortgages those markets will produce. Market refinance forecasts for 2003 by Economy.com and Freddie Mac were off by over \$2 trillion. Large transactions of mortgage purchases are essential because forecasts are not precise.

With respect to its transaction in 2003 with WaMu, Freddie Mac stated that it engaged in this transaction because HUD took a number of steps to strongly encourage the GSEs to participate in the small 5–50 multifamily mortgage market, including bonus points. The GSEs can only purchase on terms that sellers are willing to accept. Freddie Mac further stated that goals that force the GSEs to stretch their business mix in uncertain market conditions must eventually cause the GSEs to value some mortgages more than sellers do. Under these conditions, sellers will negotiate for more favorable terms. Freddie Mac stated that the seller “put” option in the WaMu transaction and a similar transaction with Citibank exemplify pro-seller terms and that these transactions advance the GSE’s regulatory purposes as well as meet the letter of the law.

In response to concerns about the options included in the swap, Freddie Mac stated that “it is the GSE’s affordable housing goal requirements, among other things, that give the sellers the negotiating power to obtain such options.” Both Fannie Mae and Freddie Mac concluded that HUD’s definition of a mortgage purchase and the counting rules should not be changed.

*HUD’s Determination.* HUD considered the comments received, with particular focus on the GSEs’ comments regarding transactions that include dissolution options. HUD is concerned that transactions of this type, which both GSEs undertook in 2003 to achieve their affordable housing goals, are not fully consistent with the purposes of FHEFSSA, which are to award goals credit for mortgage purchases that increase market liquidity for affordable housing. When a seller can exercise its option to reverse or unwind a transaction and take back the mortgages within a specified time period, the transaction appears temporary in nature, and the liquidity that might result from the transaction also appears transitory.

The drafters of FHEFSSA intended that the GSEs provide liquidity for affordable housing where such liquidity would otherwise not exist or where it would be less reliable. HUD is aware that even short-term liquidity, as may occur with dissolution options, can be of value to mortgage sellers, especially

for balance sheet management or other purposes, but sellers seeking such options are generally not constrained in locating short-term liquidity solutions, especially when these solutions are backed by seasoned mortgage loans.

Further, HUD believes that placing no constraints on goals eligibility for transactions with dissolution options would have the effect of encouraging transactions that are so short-term as to be dissolvable almost immediately after they have been counted towards the housing goals. Such an outcome is clearly at odds with FHEFSSA.

Therefore, HUD has determined to amend its counting rules to provide that for units acquired in transactions with seller dissolution options to count toward the housing goals, such options must provide for a lockout period that prohibits the exercise of the dissolution option for at least one year from the date on which the transaction was entered into and the transaction cannot be dissolved during the one-year period. The Secretary may grant an exception to the minimum lockout period, in response to a written request from a GSE, if the Secretary determines that the transaction furthers the GSE's statutory purposes and the purposes of FHEFSSA. Where a mortgage purchase involving a seller dissolution option has been counted toward the housing goals under a transaction subject to this provision, the transaction may not be dissolved (either by the exercise of the seller dissolution option, or by separate agreement entered into by the GSE and the seller) during the one-year minimum lockout period. If the seller of the mortgages and the GSE dissolve the transaction before that time, the transaction may no longer be counted toward the housing goals and the GSE's performance must be adjusted in accordance with this rule.

The Department defines seller dissolution option as an option for a seller of mortgages to the GSEs to dissolve or otherwise cancel a mortgage purchase agreement or loan sale. The Department, however, wishes to fully distinguish the arrangements established in these seller dissolution options from other types of agreements involving repurchases of securities or mortgages that involve the GSEs. For example, the GSE, as seller of a security, may agree to repurchase, or buy back, a previously sold mortgage-backed security on a negotiated basis from the holder of the security. HUD's regulation does not address that practice. Likewise, it does not address arrangements whereby a mortgage lender agrees to repurchase or replace a mortgage upon demand of the GSE if the mortgage

defaults. The provision also does not apply to repurchase and resale agreements where the GSE is the purchaser of the security. Rather, the transactions addressed by HUD's regulation provide, as a term of the transaction, the mortgage lender/seller—and not the GSE—with the option of dissolving the transaction and having the mortgages returned to the mortgage lender/seller.

HUD believes the one-year lockout period will prevent potential misuse of these transactions but will still allow sellers of mortgages to manage their portfolios in the medium and long term. The limit on dissolution options applies to all transactions because it is the potential for misuse, not the size of the transaction that could conflict with FHEFSSA. HUD will continue to monitor the GSEs' use of dissolution options to ensure that the one-year minimum lockout requirement is accomplishing its intended purpose. If there is a question about whether a particular transaction complies with the one-year minimum lockout requirement, HUD expects that the GSE will seek clarification from HUD regarding the appropriate treatment of that transaction under the counting rules.

With regard to modifying its definition of a "mortgage purchase," HUD has determined that defining mortgage purchases in terms of market effects would be cumbersome. The definition would have to be broad enough to encompass all of the statutory purposes, including market liquidity and market stability, and still narrow enough to exclude transactions that are legitimate in form but not in substance.

Similarly, while some commenters suggested that HUD exclude seasoned mortgages from its definition or that HUD impose a credit risk threshold for awarding goals credit, HUD believes that these measures could have unintended consequences that could potentially harm market liquidity for affordable housing. For example, HUD has encouraged the GSEs to buy seasoned portfolios of CRA loans as an important source of liquidity for these loans.

#### 11. Responses to Other Issues Raised by Commenters Relating to the Housing Goals

##### a. Feasibility Determinations

*Overview.* Section 1336(b) of FHEFSSA, together with HUD's current regulations, provides a process for determining that one or more goal levels are infeasible. This process may be initiated either by HUD or by a GSE; nothing in FHEFSSA or in HUD's

regulations limits a GSE's ability to request HUD to examine whether a particular goal may be infeasible. If HUD determines that a GSE has failed to meet a housing goal, or that there is a substantial probability that a GSE will fail to do so, HUD must notify the GSE and provide an opportunity for the GSE to respond. HUD must then determine whether or not the goal was feasible. If HUD determines that the goal was infeasible, then no further HUD action to enforce the goal is authorized.

HUD's proposed rule did not make any changes to the process for determining whether a goal was or was not feasible. However, HUD still received comments from both Fannie Mae and Freddie Mac regarding those provisions.

*Summary of Comments.* Fannie Mae commented that "uncertainty regarding HUD's potential feasibility determination would lead Fannie Mae and Freddie Mac to engage in whatever means necessary to meet the goals, potentially resulting in market distortions." Fannie Mae recommended that the goals be set at levels that are more likely to be seen in the marketplace, rather than at the high end of market estimates.

Freddie Mac commented that an after-the-fact finding of "infeasibility" or an adjustment to the goals would not alleviate the burden imposed by unreasonable goals. Freddie Mac noted that it is very difficult to estimate the size and composition (or "goal mix") of the mortgage market in advance. Freddie Mac also expressed concern that an after-the-fact feasibility determination would require HUD to second-guess innumerable business decisions made by the GSEs, with no certainty as to how HUD would make such determinations. Finally, Freddie Mac stated that its reputation would suffer great harm during the time HUD considered its feasibility determination, and that this harm could not be undone.

*HUD's Determination.* The final rule does not make any changes to the process for determining whether a goal is infeasible for a particular year. Although HUD has never had to make a determination that a goal is infeasible, HUD believes that the process that is currently in place provides an effective framework for making a timely determination of infeasibility. If in the future it is necessary to make a determination of whether a goal is or was infeasible, HUD will make every effort to expedite the process in an effort to minimize any potential costs and uncertainty associated with the process.

**b. Specification of Underserved Areas**

*Summary of Comments.* Several commenters suggested that HUD should redefine the Underserved Areas Goal. A consensus of these commenters stated that lowering the tract income criteria from 90 (120) percent to 80 (100) percent would make the Underserved Areas Goal consistent with CRA. Several of the commenters also stated that the current definition is too broad and that lowering the tract income criteria to 80 percent or 100 percent when the minority population is greater than 50 percent (as opposed to 30 percent currently) of the tract would focus the goal on truly underserved areas. One commenter suggested including a borrower income criteria, such as less than 80 percent of area median income, in the Underserved Areas Goal to further focus the goal on the underserved.

*HUD's Determination.* As discussed in Appendix B to this rule, HUD has determined not to go forward with redefining the Underserved Areas Goal at this time.

**c. Reconciling the CRA and the Affordable Housing Goals**

*Summary of Comments.* Several commenters from trade associations and policy organizations suggested that HUD could more sharply focus GSE activity on low- and moderate-income homebuyers by encouraging greater purchases of CRA loans. According to these commenters, this could be accomplished by establishing a new CRA goal or by establishing CRA subgoals under each of the current Housing Goals.

The CRA requires depository institutions to help serve the credit needs of their communities and authorizes federal regulators to examine the level of lending, investment, and service that these institutions provide. Commenters noted that under section 1335 of FHEFSSA, Fannie Mae and Freddie Mac are directed to "take affirmative steps to assist insured depository institutions to meet their obligations under the CRA which shall include developing appropriate and prudent underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures." These commenters noted, however, that under FHEFSSA, the definitions for key categories of borrowers served through affordable housing goals differ from those established for borrowers served under CRA.

Under FHEFSSA, the definition for "low income" is a borrower at or below

80 percent of area median income, while for CRA purposes, the definition of "low-income" is a borrower at or below 50 percent of area median income. Similarly, the affordable housing goal definition of a "moderate income" borrower is at or below 100 percent of area median income, while for CRA purposes, "moderate income" is defined as at or below 80 percent of median area income.

Commenters pointed out that these definitional discrepancies create a mismatch between the loans made by the primary market institutions and those purchased by the GSEs to meet affordable housing goals. The result is that the GSEs can meet their goals by purchasing loans to borrowers in higher income ranges than those mandated under CRA, which may result in less liquidity available to primary mortgage market lenders to make additional low and moderate income loans.

These commenters recommended that HUD find a way to resolve the apparent contradiction between the definitions. One commenter suggested that HUD has the authority to align the affordable housing goals with the CRA definitions without additional legislation. This commenter recommended that HUD require the GSEs to report low-income loans in two categories—"low income" and "very low income"—and conform the definitions of low-income and moderate income to the CRA definitions.

Other commenters however, indicated that legislative correction would be needed to accomplish such alignment. These commenters recommended that until that time, HUD should consult with federal bank and thrift regulators to determine the CRA-eligible market share and adjust the affordable housing goals for Fannie Mae and Freddie Mac accordingly.

Several commenters recommended that HUD should consider establishing specific "CRA loan sub-goals" under the existing goals for the GSEs. One commenter suggested that HUD could create a new goal that requires the GSEs to purchase stated amounts of CRA-eligible home purchase mortgages, with low and moderate income subgoals based on the CRA measures.

*HUD's Determination.* After close review of this issue, HUD has determined that full harmonization between affordable housing goals and CRA definitions will require legislative action. Income brackets for the goals under FHEFSSA and under CRA are statutorily defined, and CRA definitions allow for much greater discretion by examiners to determine CRA scoring. For example, under CRA, the distinction

between home improvement loans and small business loans secured by housing may not match HUD's definitions of mortgage purchases. In contrast, HUD does not use a system of examiners to determine the goals eligibility of sellers dealing with the GSEs, and comparison areas are established through regulation.

In light of these legal constraints, HUD will not make any changes to the housing goals to address CRA concerns at this time.

**d. Predatory Lending**

*Summary of Comments.* Certain commenters urged the Department to adopt predatory lending safeguards in the final rule that would prohibit Housing Goals credit for purchases of loans that included mandatory arbitration clauses or loans with prepayment penalties beyond three years towards the goals. The GSEs did not specifically mention this issue in their comments to HUD. HUD's proposed rule did not suggest changes to its existing GSE regulations that address predatory lending practices.

*HUD's Determination.* The Department continues to vigorously oppose specific lending practices that are predatory or abusive in nature. As stated in the 2000 rulemaking, the GSEs should seek to ensure that they do not purchase loans that actually harm borrowers and support unfair lending practices. In that rulemaking, the Department determined that the GSEs should not receive the incentive of goals credit for purchasing high cost mortgages, including mortgages with unacceptable features.

The Department is authorized under 24 CFR 81.16 to determine whether to provide full, partial, or no credit toward achievement of any of the housing goals for any transaction. The Department's existing rules contain strong safeguards against abusive lending by excluding certain types of mortgages from counting towards the affordable housing goals. These include loans with excessive fees, and prepayment penalties in certain loans.

The Department is aware that certain practices that were not enumerated in the regulations adopted in 2000, such as loans with prepayment penalties after three years and loans with mandatory arbitration clauses, often lock borrowers into disadvantageous loan products. The Department will rely on existing regulatory authorities to monitor the GSEs' performance in this area. Should the Department later determine that there is a need to specifically enumerate additional prohibited predatory practices, it will address such practices at a future time.

#### e. Minority Subgoals/Goals

*Summary of Comments.* Among the many suggestions HUD received for subgoals and bonus points, several advocacy groups recommended that HUD directly target minority mortgage purchases such as those made to Native Americans. These groups note that homeownership rates are not equal across ethnic groups. Fewer Blacks and Hispanics own their own homes than the general population. Although the GSEs have made some progress in this area, the GSEs are still less likely to serve high minority areas than other lenders. In the view of these commenters, the absence of the GSEs has led to higher borrowing costs and harsher borrowing terms for minority borrowers because they are more likely to deal with nontraditional and predatory lenders.

*HUD's Determination.* Under FHEFSSA, HUD does not have statutory authority to establish goals beyond those enumerated in the statute. FHEFSSA directs HUD to establish a goal for underserved areas, and HUD's goal includes census tracts with high concentrations of minority households (and with median income below a certain level) as one category of underserved area. The statute does not empower HUD to establish a goal based on the characteristics of borrowers, other than by income of borrower.

Even without an explicit subgoal, HUD believes that the goals structure will address the concerns of minority borrowers. As discussed in the introduction, minorities and immigrants are a growing percentage of homebuyers and many more aspire to home ownership. Demographics dictate that these buyers will become increasing shares of the conventional conforming market. Requiring the GSEs to lead the market will encourage them to do even more to reach out to minorities.

#### f. Technical Change to § 81.16(c)(7)

In addition to the preceding changes being made at this final rule stage, HUD is making a technical change to § 81.16(c)(7) to correct a cross-reference. Paragraph (c)(7) addresses the treatment of refinanced mortgages. The paragraph includes a reference to § 81.14(f), which is not related to refinanced mortgages. Section 81.16(c)(7) in this final rule is revised to correct this cross-reference.

#### D. Subpart I—Other Provisions

##### 1. Overview—Verification and Enforcement To Ensure GSE Data Integrity

HUD proposed to amend § 81.102 (Independent Verification Authority) of

its regulations to incorporate certain data integrity procedures designed to ensure the accuracy, completeness, and timeliness of housing goal information submitted by the GSEs to the Department. These procedures included: (1) A requirement that the GSEs provide a certification with their Annual Housing Activity Reports (AHAR) and such other reports, data submissions, and information that the Department may request in writing be certified; (2) a procedure to adjust current year-end errors, omissions, and discrepancies in data submissions to HUD; and (3) a procedure for correcting prior year overstatements of performance due to reporting errors, omissions, or discrepancies in a GSE's AHAR. HUD also restated in the proposed amendment to § 81.102 the enforcement options and remedies under FHEFSSA and HUD's regulations that could result from a determination that a GSE's data submissions, information, or reports were not current, were incomplete, or otherwise contained an untrue statement of material fact.

In addition to comments provided by the GSEs, HUD received comments from groups that included mortgage lenders, non-profit and policy advocacy organizations, and trade associations. Most commenters supported the data verification provisions of the proposed rule. However, one mortgage lender stated that the proposed certification would impose a severe burden on the GSEs and lenders. Another suggested that the data integrity process should include some leeway for unintentional mistakes so that it does not become burdensome. A trade association stated that HUD should not enact regulations that would put additional data integrity burdens on lenders. Fannie Mae and Freddie Mac provided detailed comments on each proposal. These comments are discussed more fully in the following sections.

##### 2. Independent Verification Authority—§ 81.102(a)

As it proposed, the Department is retaining and recodifying the provisions of the current § 81.102(a) that provide that HUD may independently verify the accuracy and completeness of data, information and reports submitted by a GSE in addition to the Department's existing authority to conduct on-site verifications and performance reviews. HUD is redesignating this section, as HUD proposed, as § 81.102(a).

##### 3. Certification—§ 81.102(b)

To ensure the highest degree of corporate accountability, and to be

consistent with the customary practice of regulators of financial institutions, the Department proposed that the GSEs be required to provide a certification with their AHAR reports and such other report(s), data submission(s), or information for which HUD requests certification in writing. HUD proposed a certification that consisted of the following four parts: (1) The GSE Certifying Official has reviewed the particular AHAR, other report(s), data submission(s) or information; (2) to the best of the GSE Certifying Official's knowledge and belief, the particular AHAR, other report(s), data submission(s), or information are current, complete, and do not contain any untrue statement of a material fact; (3) to the best of the GSE Certifying Official's knowledge and belief, the AHAR or other report(s), data submission(s), and information fairly present in all material respects the GSE's performance, as required to be reported; and (4) to the best of the Certifying Official's knowledge and belief, the GSE has identified in writing any areas in which the GSE's particular AHAR, other report(s), data submission(s), or information may differ from HUD's written articulations of its counting rules including, but not limited to, the regulations under 24 CFR part 81, and any other areas of ambiguity.

*Summary of Comments.* Fannie Mae and Freddie Mac commented on this proposal. Each expressed many similar objections to the certification language as proposed and offered many similar recommendations. For example, both GSEs stated that the certification language was overly broad and should be modified to the form authorized in FHEFSSA for submissions to OFHEO; namely, that the report is true and correct to the best of such officer's knowledge and belief. Each recommended that the words "fairly present" be deleted from the third proposed certification statement stating that these words are meaningful only in the context of Generally Accepted Accounting Practices (GAAP), which defines standards of determining "fairness" in financial reporting, but not performance reporting.

In addition, both GSEs questioned HUD's authority to impose a certification requirement, but stated that to the extent HUD does impose this requirement, it should be the certification used by OFHEO. They also stated that the phrases "errors, omissions, discrepancies, and ambiguities," "written articulations of its counting rules," and "any other areas of ambiguity" are vague and undefined,

and that this vagueness makes it possible for HUD to arbitrarily implement the certification provision by interpreting it in a way that is not known by the GSEs. Freddie Mac also stated that HUD's informal written articulations are not enforceable and that it may not know about all of HUD's informal articulations. Both GSEs also stated that it is difficult to certify to the accuracy of information that must be included in the reports that they receive from third parties.

Freddie Mac suggested that the subject of the certification be limited to the year-end annual data tables and computerized loan-level data that it submits with its AHARs, and should not cover any narrative portions of the AHARs. Fannie Mae suggested that the certification should focus on the process it follows for generating its submissions and should cover only the final tables in the AHAR that it submits each year.

Both GSEs stated that no certification should be required for reports-in-progress, such as the housing goals progress reports each submits to HUD on a quarterly basis.

A policy advocacy group commented that the certification should be limited to reporting processes of the GSEs, not the accuracy of the underlying data obtained from individual lenders. A trade association commented that HUD should not put additional data integrity burdens on lenders.

**HUD's Determination.** HUD has considered the comments received and has determined to modify its proposal. HUD's reasons for requiring a certification were not disputed by commenters. However, HUD has revised the proposed rule language to address commenters' concerns regarding clarity. HUD has also included alternative language in the final rule that would specifically define terms as well as eliminate the language that the GSEs and others found to be ambiguous. As a result, the final rule includes a simplified certification that is much closer to the certification used by OFHEO. Section 81.102(b) has been amended to require the senior officer of each GSE who is responsible for submitting to HUD the fourth quarter Annual Mortgage Report and the AHAR under sections 309(m) and (n) of the Fannie Mae Charter Act or sections 307(e) and (f) of the Freddie Mac Act, as applicable, or for submitting to the Secretary such other report(s), data submission(s), or information for which certification is requested in writing by the Secretary to state that: "To the best of my knowledge and belief, the information provided herein is true, correct and complete."

The Department has also included language to clarify that it may pursue enforcement action against a GSE that fails to provide the certification required under § 81.102(b). In addition, the Department may pursue enforcement action if a GSE submits the certification required under § 81.102(b), but the Secretary later determines that the data, information or report(s) are not true, correct and complete. For data, information and report(s) subject to § 81.102(c) or (d), the final rule makes clear that the Department will only pursue enforcement action against a GSE in connection with material errors, omissions or discrepancies, as those terms are defined therein.

The GSEs have asserted that HUD may not require certification of any information they submit because the Department has no express statutory authority to do so. The Department's authority to require certification of information submitted by the GSEs is authorized under HUD's general regulatory power over the GSEs under section 1321 of FHEFSSA as well as its authority to monitor and enforce the GSEs' compliance with the housing goals under section 1336. (See the preamble of HUD's proposed rule at 69 FR 24247–24248 for a full discussion of HUD's authority to require certification.)

In requiring this certification, HUD is fully aware that the GSEs collect millions of data elements from hundreds of sources and that the GSEs must depend upon these sources to provide accurate data. In requiring a certification, HUD intends that the GSEs will use and rely upon their internal controls and other due diligence processes and procedures for collecting, compiling, verifying the accuracy of, and reporting the data received from sellers. HUD will evaluate the sufficiency of this certification beginning with the 2005 fourth quarter Annual Mortgage Report and the AHAR to determine whether it is serving its function of providing adequate assurance as to the accuracy and completeness of information.

With respect to the scope of the certification, HUD believes it is appropriate and reasonable that the certification statement apply to the entire AHAR submission, including the narrative text, data tables, and computerized loan-level data. Section 309(n) of Fannie Mae's Charter Act and section 307(f) of the Freddie Mac Act specify the types of information each GSE is required to report, including narrative descriptions as well as data. HUD expects that all of the required information, not just the data and data tables, will be subjected to appropriate

internal review processes by the GSEs. A certification regarding the entire report helps to ensure the GSEs' accountability for the information that they are required to report accurately under their charters.

Although Fannie Mae recommended that the certification should apply only to the tables in the AHARs and Freddie Mac recommended that the certification should apply only to the data tables in the AHAR and the loan-level data it submits with its AHAR, from time to time HUD requires one or both GSEs to submit other report(s), information, or data submission(s) that rise to a sufficient level of importance to HUD's oversight work that a certification statement is warranted. The final rule, therefore, retains this provision and further provides that the Secretary will issue a written notification to the GSE whenever such a certification is required. HUD expects that any additional certification requirements will be the exception rather than the rule to ensure that the routine and necessary flow of information is not impeded.

Both GSEs recommended that HUD not impose a certification on any progress reporting, such as the quarterly housing goals performance reports each submits to HUD. HUD did not propose that such reports be certified and reiterates that certification statements will not be required for the GSEs' first three quarterly housing goals reports and any other report(s), data submission(s) or information that represent incomplete "snapshots" or information that is being gathered but which is not in final form. Certification will be required for the fourth quarter report, *i.e.*, the Annual Mortgage Report.

#### 4. Adjustment To Correct Current Year-end Errors, Omissions or Discrepancies—§ 81.102(c)

HUD routinely conducts computerized consistency checks of loan-level data received from the GSEs as part of their AHAR reporting. This data are received on March 15th of each year for the previous year's performance. These reviews verify that the GSEs have applied HUD's counting rules and goals eligibility standards appropriately in determining their year-end performance. A key procedure involves applying HUD's counting rules to the GSEs' loan-level data for the purposes of replicating the performance figures computed by the GSEs in their AHARs. Also, in conjunction with other reports provided by the GSEs, including a report that reconciles all adjusted mortgage purchases (the denominator) with the GSE's total business volume as

reported in the annual report to shareholders or other information filings, HUD's reviews also verify the completeness of the data. If HUD finds discrepancies between its results and those reported by the GSEs, HUD works with appropriate GSE staff to resolve the discrepancies after which HUD makes a final determination of year-end results and publishes these as HUD's official performance figures for the year.

HUD's proposed rule provided for a timeframe within which the GSEs may comment or otherwise respond to HUD's findings of errors, omissions, or discrepancies with additional information. If a GSE did not respond with information to correct or explain the error, omission, or discrepancy to HUD's satisfaction within five working days of HUD's initial notification, then HUD would notify the GSE in writing and seek clarification or additional information. At this point, the GSE would have 10 working days in which to respond and could request an extension of an additional 20 working days from HUD. If the GSE still did not respond in a manner that corrected the error, omission, or discrepancy, then HUD would determine the appropriate adjustment to the numerator and denominator of the applicable goal and/or subgoal. Currently, there are no required time limits within which the GSEs must respond to HUD's inquiries for additional information, and there is no procedure by which HUD can bring the process of reviewing a GSE's current year submission to closure absent voluntary assistance from the GSEs. The practical effect of not codifying a timetable for completion of this process is that HUD could be delayed in fulfilling its responsibilities to issue a timely, official report on the GSEs' performance for the year most recently ended and to produce the public use database.

*Summary of Comments.* In addition to the GSEs, many organizations, including policy advocates, trade associations, and one non-profit group, commented on the data verification provisions of HUD's proposed rule. Nearly all of these comments supported implementation of some type of data verification procedures. One trade group stated that data verification regulations should be enforced to get more accurate information. However, another trade group expressed concern that the data integrity process should include some leeway for unintentional mistakes to avoid becoming burdensome. Two advocacy organizations supported the proposed provisions regarding data verification but thought HUD should

give the public the ability to comment on the GSEs' AHARs.

Both GSEs commented in detail on HUD's proposal. Both expressed concerns about the scope of this provision and questioned what procedures, especially adjustment notification and enforcement procedures, would be associated with its implementation. Freddie Mac augmented its comments with a legal opinion from outside counsel.

With respect to the words "errors, omissions and discrepancies," the GSEs contended that these terms were vague and needed further definition. Freddie Mac stated that without such further definition, HUD could disallow counting of units based upon interpretations of its rules of which Freddie Mac was unaware, and thus violate the fair notice doctrine. Freddie Mac suggested that if HUD retained the use of these words in its regulation, it should explain how their meanings differ. Fannie Mae stated that potential adjustments should apply only to situations where the GSE failed to follow HUD's rules for data collection and reporting, and not where it failed to follow its own rules for procedures in data collection and reporting. Fannie Mae also contended that adjustments should be made only where the error, omission or discrepancy was in a data field that affected scoring and where it also had a material effect on compliance with a housing goal. Freddie Mac stated that adjustments should be made only for material errors or omissions. Fannie Mae stated that a GSE should be subject to additional enforcement action only when an error, omission or discrepancy is due to intentional or bad faith action.

Both GSEs stated that HUD's regulations should provide that HUD will issue a written determination to a GSE when it determines that an adjustment is necessary, that HUD should specify which official within HUD is authorized to issue orders under proposed § 81.102(c) and (d), and that the rule should provide for more lenient time frames for responding to HUD's inquiries. In addition, Freddie Mac commented that the regulations should state that an order requiring an adjustment constitutes "final agency action" for purposes of judicial review under the Administrative Procedure Act and that judicial review is immediately available.

Fannie Mae also commented on the title of HUD's provision stating that a provision to correct "current year end errors" is confusing because HUD cannot correct errors for a current year when it does not receive the data about any current year until the next year.

*HUD's Determination.* HUD has considered the comments and determined that a provision specifying what procedures HUD will use in developing its official performance numbers for the immediately preceding year is necessary. HUD notes that many of the concerns expressed by commenters, especially the GSEs, involve the lack of definition of the terms "errors, omissions or discrepancies" and a lack of clarity regarding how the regulation will be enforced. Accordingly, in the final rule, HUD has added a paragraph that defines an "error" as a technical mistake, such as a mistake in coding or calculating data. Mistakes of this type may also include, but not be limited to, systems errors, such as those related to geocoding or misapplication of HUD's most current data regarding median income or underserved areas. An "omission" is defined as a GSE's failure to count units in the denominator. A "discrepancy" is defined as any difference between HUD's analysis of data and the analysis contained in a GSE's submission of data, including a discrepancy in goal and/or Special Affordable subgoal performance.

The Department also clarifies in § 81.102(c)(5) of this final rule that an error, omission or discrepancy is "material" if it results in an overstatement of credit for a housing goal or Special Affordable subgoal and, without such overstatement, the GSE would have failed to meet such housing goal or Special Affordable subgoal for the immediately preceding year. Finally, the rule defines the term "year-end data" to mean data that HUD receives from the GSEs related to housing goals performance in the immediately preceding year and covering data reported in the fourth quarter Annual Mortgage Report and the GSE's AHAR.

With respect to procedures for notifying a GSE of any suspected error, omission or discrepancy, HUD is responding to the concerns raised by the commenters by amending the proposed rule to: (1) Provide that, with regard to each initial notification by HUD to a GSE, HUD may, in its own discretion, or upon a request by a GSE, extend the initial five working day response period for up to 20 additional working days; (2) establish that any person with delegated authority from the Secretary, or the Director of HUD's Financial Institution Regulation Division, or his or her designee, is responsible for issuing initial notifications regarding errors, omissions, or discrepancies, making determinations on the adequacy of responses received, approving any extensions of time permitted under this

provision, and generally managing the data verification process; (3) establish that the Secretary or his designee will inform a GSE in writing of HUD's determination of official performance figures, including any adjustments, five working days prior to HUD's release of its official performance figures to the public; (4) provide that during the five working days prior to such public release, a GSE may request reconsideration in writing of HUD's final determination of its performance in which case the Secretary will decide whether to grant the request for reconsideration, and if the request is granted, make a final determination on the request for reconsideration within 10 working days of the Secretary's granting of the GSE's request for reconsideration; and (5) provide that, with the exception of the written determination of HUD's official performance figures, all other notifications under this provision may be by electronic mail.

HUD has also clarified through its definitions of errors, omissions and discrepancies, that an "adjustment" will be made in situations where a GSE failed to follow correct procedures in data compilation and reporting and/or where it failed to comply with HUD's regulation for determining eligible units. As has been the case in the past, HUD expects that any adjustments that it may make to the numerator or denominator, that result in a difference between the GSE's performance as stated in the GSE's AHAR for the immediately preceding year and HUD's official performance figures, will be well understood by the GSE because adjustments of this type occur routinely during HUD's verification work.

HUD is also clarifying that it intends to treat a GSE's material errors, omissions or discrepancies in, or failure to certify, data submissions under § 81.102(c) as a failure to submit information that the GSE is required to submit under its charter. Accordingly, the Department may pursue the additional enforcement remedies authorized under § 81.102(e).

With respect to events that could trigger enforcement under this provision, HUD does not intend that routine technical errors or omissions would warrant such enforcement. In order to trigger the enforcement provision, errors, omissions or discrepancies discovered during review of the immediately preceding year's performance must be material, as HUD has defined that term. The error, omission or discrepancy also must be one that indicates to HUD a serious problem in the GSE's internal

procedures. Examples of errors, omissions, or discrepancies that could rise to this level under these criteria include a GSE counting units that are not eligible under HUD's rules for goals credit or a GSE underreporting units in the denominator. With respect to Freddie Mac's suggestion that HUD's regulations should state that this determination is "final agency action" for purposes of the Administrative Procedure Act and is immediately subject to judicial review, FHEFSSA already provides that the GSEs may obtain judicial review in connection with proceedings to enforce the housing goals, and that those proceedings shall be governed by the Administrative Procedure Act. Therefore, the Department declines to adopt Freddie Mac's suggestion.

To more clearly define the scope of this provision, HUD has renamed this provision in the final rule as Verification Procedure and Adjustment to Correct Errors, Omissions, or Discrepancies in AHAR Data for the Immediately Preceding Year.

#### 5. Procedures for Prior Year Reporting Errors—§ 81.102(d)

The annual data verification review for the immediately preceding year described in § 81.102(c) was designed to ensure that reported goals performance was correctly calculated in accordance with HUD's regulations. Although these reviews can test for the reasonableness of some reported data, the reviews cannot generally determine the accuracy of the underlying loan-level data. To monitor data accuracy, HUD has implemented a second type of procedure, called performance reviews. Performance reviews are especially necessary because housing goals are calculated from information (e.g., number of dwelling units) that is not reported in the GSEs' financial statements and is, therefore, not subject to all GSE procedures designed to ensure the accuracy and completeness of reported financial information. HUD's performance reviews ensure that rigorous audit procedures, either similar or identical to those used to monitor the integrity of financial data, are also used in monitoring the accuracy, completeness, and timeliness of the data each GSE submits to HUD. Performance reviews include, but are not limited to, evaluating the GSEs' internal controls over the collection, management and reporting of loan-level mortgage data used in calculating housing goals performance. Performance reviews may also focus on the GSEs' quality control standards and procedures for information received from loan sellers

and securities issuers and dealers and may include additional procedures to test random samples of data for accuracy and completeness. To supplement HUD's on-site performance review work, the Department has implemented specialized reporting by which each GSE informs HUD on a scheduled basis of key issues and findings relevant to goals reporting. For example, the GSEs report to HUD quarterly on the results of their own internal reviews and self-assessments related to housing goals. These reports cover all actions taken by the GSE to remove any findings related to weaknesses in controls or procedures, including those findings identified by HUD.

Because of the complexity of each GSE's business, as well as the complexity of many of the transactions that the GSEs undertake to meet their housing goals, there is a possibility that HUD may discover, during a performance review, that a serious overstatement of credit towards one or more housing goals occurred in the reported prior year under review. Currently, HUD has no procedure for ensuring that any such overstatement is corrected or otherwise adjusted in some manner unless the overstatement is discovered in the review of the immediately past year's data during the replication review described in § 81.102(c). To remedy this, HUD proposed a procedure that would adjust a GSE's current year performance by deducting from the numerator of the relevant housing goal or subgoal the number of overstated units from a prior year. A prior year was any one of the two years preceding the current reporting year.

*Summary of Comments.* Many organizations commented on HUD's data integrity provisions in general and nearly all of these organizations expressed support for data verification. The GSEs commented more specifically on HUD's proposals for adjustments to make up prior years' overstatements. The GSEs asserted that the Department does not have authority to either deduct credit from a current year's purchase that is entitled to credit under HUD's regulations or add to a current year's housing goal to compensate for the GSE's failure to meet its goals in a prior year. They also had other objections, including the objection that the only remedy provided in FHEFSSA for any failure to meet housing goals is the imposition of a housing plan, which may address only a probable failure to meet housing goals in the current year or actual failure to meet goals in a current year in the next calendar year.

The GSEs stated that the Congress intended the statute to provide no remedy for their failure to meet a prior year's housing goal and, therefore, that the Department has no authority to fashion such a remedy. Based on this line of reasoning, they concluded that HUD may not take any action against a GSE when it discovers that it failed to meet a housing goal in a prior year, even though HUD could have taken action if the failure had been discovered within one year after the year in which it occurred.

Both GSEs also objected to the policy basis for HUD's proposal. For instance, Fannie Mae wanted the time period within which HUD might impose a prior-year correction shortened from up to 24 months to three months after HUD's receipt of AHAR loan-level data, which HUD receives on March 15th of each year. Fannie Mae cited OFHEO's ability to render a decision on its final capital classification within 90 days of the reporting quarter as evidence that complex determinations can be made within short time frames. Freddie Mac saw no reason why the necessary evaluations could not be accomplished within six months after the close of the immediately preceding year. Freddie Mac stated that HUD's policy justification does not support the proposal and that HUD did not point to any instance where the increasing complexity of transactions has led to overstatements in performance. Freddie Mac also commented that the Department already has the option of publicizing the discovery of any prior year mistakes—by press release, news conference or its Web site information—and of making Congress aware of these mistakes.

Freddie Mac requested that HUD withdraw the proposal entirely. If HUD opted to proceed to implement the proposal, then Freddie Mac suggested that HUD amend the provision to: (1) Limit application of the rule to large prior year overstatements that affect a material number of units under a goal (e.g., five percent); (2) provide that HUD will apply the rule only when a GSE acted in bad faith; (3) provide that HUD will not apply the rule cumulatively; that is, that HUD will not accumulate several years' over-counts and then deduct a cumulative total from the current year; and (4) clarify in the final rule which official within HUD will make decisions under this provision and provide that the basis for decisions be explained.

*HUD's Determination.* HUD has carefully considered both GSEs' comments, including their legal and policy arguments. The Department

agrees that the only remedy Congress set out in FHEFSSA for failing to meet a housing goal is a housing plan under section 1336, and as the statute is written, the housing plan addresses only a current year's failure, either in that year or in the next calendar year. Therefore, the statute does not specifically address a GSE's failure to meet a housing goal in a prior year, *i.e.*, a failure occurring in any one of the two years immediately preceding the latest year for which data on housing goals performance was reported to HUD. However, the Department does not agree that Congressional silence on this precise issue means either that Congress intended the GSEs to be allowed to fail to meet their housing goals as long as the Department does not discover that failure within a specific time or that the Department may not fashion a remedy to address this issue. This conclusion runs counter to Congress's purposes in enacting FHEFSSA, which directs HUD to establish and monitor the GSEs' compliance with the Housing Goals.

Section 1336 of FHEFSSA provides that the Secretary shall "monitor and enforce" the GSEs' compliance with the housing goals set by the Department. According to FHEFSSA's legislative history, in enacting FHEFSSA Congress intended "to establish a *comprehensive* framework of goals, data collection, reporting requirements and enforcement provisions." S. Rep. No. 102-282, at 34 (1992)(emphasis added).

When discussing the GSEs' duties to meet housing goals set for low- and moderate-income housing and housing in central cities and rural areas, Congress stated:

The GSEs need to provide more leadership in all of these areas, and they have indicated a desire to do so. But direct and potentially forceful federal oversight is the only way to ensure that it will happen. *Id.* at 11.

Under the GSEs' suggested construction of FHEFSSA, HUD's ability to enforce the housing goals is totally dependent upon only one factor, namely how quickly HUD discovers that a GSE has failed to meet a goal. In order to determine whether a GSE has failed a goal, HUD must receive, verify and analyze massive amounts of data, as described above. Under the GSEs' suggested construction of FHEFSSA, only if HUD discovers that a GSE has failed to meet a housing goal or subgoal in the nine month period that runs from March 15th, when the GSEs submit current year-end data, to the end of that year—may HUD enforce the housing goals for that year. Such a construction is not only unreasonable on its face but it is contrary to the plain intent of

Congress as expressed in the FHEFSSA and its legislative history. FHEFSSA and its legislative history indicate that Congress established a comprehensive regulatory scheme under which HUD would establish and enforce the Housing Goals through strict and pervasive regulation.

Furthermore, there is absolutely no statement in FHEFSSA or its legislative history to suggest that Congress intended that HUD must ignore or forgive a GSE's failure to meet its housing goals in any year for any reason, including the passage of a certain amount of time before HUD discovers this failure. The fact that FHEFSSA is silent on the issue of how to address a GSE's failure to meet a prior year's housing goal means that there is a gap in FHEFSSA's enforcement scheme regarding this precise issue. Under *Chevron v. NRDC*, 467 U.S. 837 (1984), the Department has discretion to fashion an appropriate remedy to fill this gap, and it has done so in § 81.102(d). Moreover, the Department has the discretion to fashion a remedy to correct prior year overstatements without which a GSE would have failed to meet a housing goal or Special Affordable subgoal under its general regulatory powers under section 1321 of FHEFSSA.

However, in light of the objections raised to the proposed regulation in the comments discussed above, HUD has revised § 81.102(d) to remove provisions that either provide for deduction of Housing Goals credit in a current year from purchases that qualify for credit, or that add requirements to a current year's Housing Goals due to errors, omissions or discrepancies in a prior year's data submissions. The final rule provides instead that the Secretary may require the GSEs to make up any overstatements of goal performance without which a GSE would have failed to meet a prior year's Housing Goal, no later than the year following the year in which HUD first notifies the GSE of this failure. (The rule now defines the term "prior year" to mean any one of the two years immediately preceding the latest year for which data on housing goals performance was reported to HUD.)

In order to remedy this failure, the Secretary may require the GSEs to purchase additional mortgages that finance a number of units that either (a) equal the number of units overstated in the prior year's goal performance, or for the Special Affordable subgoals the number or dollar amount, as applicable, of mortgage purchases that the Secretary has determined were overstated, or (b) that equal the percentage of the overstatement in the prior year's goal

performance as applied to the most current year-end performance, whichever is less. Units purchased to remedy an overstatement must be eligible to qualify under the same goal or goals for which the overstatement occurred in the prior year. For example, a GSE may have overstated a prior year's performance by 5,000 units or .22 percent under the Low- and Moderate-Income Goal. To make up this overstatement, a GSE may purchase an additional 5,000 units that are eligible under the Low- and Moderate-Income Goal in the year immediately following the year in which HUD notifies the GSE of the overstatement or it may multiply the current year's total eligible purchases under the Low- and Moderate-Income Goal by the overstated percentage from a prior year (e.g., .22 percent) to determine the number of units that must be purchased, provided this number is less than 5,000 units. The same requirement also applies to the Special Affordable Home Purchase Subgoal. When an overstatement occurs under this Subgoal, the Secretary may require the GSE to make up the number of mortgages that were overstated using the lesser of the two procedures previously described. For overstatements under the Special Affordable Multifamily Subgoal, the GSE may be required to make up the dollar amount of overstatement by purchasing qualifying multifamily mortgages in an amount equal to the overstatement. The GSEs will not be required to make up any errors, omissions or discrepancies in prior years that were not material. As previously noted, the final rule provides that an error, omission or discrepancy is material if it results in an overstatement of credit for a housing goal or Special Affordable subgoal and, without such overstatement, the GSE would have failed to meet such housing goal or Special Affordable subgoal for the prior year.

Also, corrections for overstatement of goals performance under this provision will not be counted or reported under the GSEs' Annual Housing Activity Report, including calculation of housing goal performance in any year, but rather will be managed separately from the housing goals as directed by HUD.

If the GSE does not purchase a sufficient number of eligible units or mortgages, as described previously, then HUD may issue a notice that the GSE failed a housing goal or subgoal in a previous year, or seek additional enforcement remedies under § 81.102(e) or any other civil or administrative remedies that are available under applicable law. The Department is

treating a GSE's material errors, omissions or discrepancies in, or failure to certify, a prior year's data submission as a failure to submit information that the GSE is required to submit under its charter.

Both GSEs also questioned the need for an adjustment period that could extend for up to 24 months from the close of a calendar year's performance, believing instead that any such review could be accomplished within six months of the close of the previous year, which is a time frame similar to that used by OFHEO to assess the adequacy of a GSE's capital. As HUD has stated previously, reviews conducted immediately upon receipt of a GSE's prior year loan-level data and pursuant to § 81.102(c) cannot generally gauge the accuracy of the data and cannot always determine whether the transaction itself complies with HUD's regulations for counting units towards goals performance. Assessments of this type require the application of procedures, either in whole or in part, that are characteristic of audit engagements. For example, it is customary for audits of a previous year's financial statements to require up to one year or more for completion due to the number of procedures involved and the volume of information to be reviewed, especially for exceedingly large and complex organizations. Similarly, the relatively new field of performance data auditing, including reviews based on some or all of these procedures, also requires a substantial commitment of time and resources if meaningful results are to be obtained. For these reasons, performance reviews are not analogous to OFHEO's evaluations of capital adequacy. HUD believes that its original proposal of allowing for up to 24 months after the close of the year under review is the appropriate time frame for completion of the performance review.

The GSEs also expressed some concerns about the potential for HUD to make determinations of error after the fact and without any prior notice to a GSE that a type of transaction and/or housing unit would not be eligible for goals credit. HUD believes it is useful to more fully describe the types of errors likely to trigger a finding that units were overstated. In the context of performance reviews, the words "errors, omissions or discrepancies" connote serious mistakes, such as those associated with violations of HUD's counting rules and other goals eligibility criteria as set forth in its regulations. HUD is aware that in collecting and reporting millions of data elements, some level of factual error is probably unavoidable. However, with regard to

data accuracy in performance reviews, HUD is concerned with errors of a substantial nature, such as those that suggest a larger internal control problem, an example of which could be a pattern of incorrect rental data acquired from or generated by the same source. HUD is also concerned with types of transactions that are either expressly prohibited from goals eligibility, such as high cost mortgages, or for which HUD approval may have been required but not obtained prior to a GSE counting the units, such as the use of an affordability estimation methodology. Other similar types of problems may also trigger a HUD determination of error. In the event HUD supplements its regulations with letters to one or both GSEs regarding appropriate counting treatment, the GSE will be responsible for complying with only the specific directives it has received from HUD. In the final rule, HUD has reiterated that this procedure will apply only in those instances where an overstatement was material in nature; that is, the overstated units enabled the GSE to meet a housing goal that it otherwise would not have met. In the event that HUD undertakes a performance review that covers a two-year period and determines that material misstatements of housing goals or Special Affordable subgoals performance occurred in both years, then HUD will apply the same procedures as described previously for making up the overstatements. Upon a written request from a GSE, the Secretary may, in his discretion, determine to grant an extension of additional time to correct or compensate for the overstatement. For example, if overstatements were discovered for years 2005 and 2006 and the GSE is notified of the overstatements for both years in 2007, then the GSE could be required to make up the overstatements for both years in 2008. Similarly, if the overstatement was discovered for one year, 2005, and the GSE was notified of the overstatement in 2006, then the GSE could be required to make up the overstated units or mortgages in 2007. In both examples, upon receipt of a GSE's written request for an extension of time, the Secretary may grant an extension for completing make up of the overstated units or mortgages.

With regard to HUD's reasons for implementing a procedure that provides a mechanism by which overstated units of a material nature from a prior year can be made up in a subsequent year following the year a GSE is first notified of the overstated units, for reasons stated above, it is the Department's view

that it has authority to do so, and that the procedure is needed at this time. The procedure is the only tool by which HUD can meet its statutory responsibility to assure the integrity of all of the housing goal data reported to the public, including the data reported in the GSE public use database and its duty to enforce the housing goals.

#### 6. Additional Enforcement Option § 81.102(e)

The Department proposed a new § 81.102(e) that would provide HUD with additional enforcement options in the event it determines that a GSE has submitted data, information, or report(s) that are not current, are incomplete, or otherwise contain an untrue statement of material fact. Section 81.102(e) identified the data, information, or report(s) that would be subject to HUD's additional enforcement authority as those required under section 307(e) and (f) of the Freddie Mac Act, section 309(m) or (n) of the Fannie Mae Charter Act, or under 24 CFR part 81, subpart E.

The Department indicated in proposed § 81.102(e) that it could make a determination—either under its independent verification authority in § 81.102(a) or by “other means”—that such data, information or report(s) are not current, are incomplete, or otherwise contain an untrue statement of material fact. This reference to “other means” was intended to encompass the Secretary's authority under the three other provisions in § 81.102 that were also being proposed to ensure the accuracy, truthfulness and completeness of GSE submissions to HUD: (1) The proposed GSE certification in § 81.102(b); (2) the proposed procedure established in § 81.102(c) to verify the accuracy and completeness of the GSE's current year-end data; and (3) the proposed procedure established in § 81.102(d) to ensure the accuracy and completeness of the GSE's prior years' data.

The Department further provided in § 81.102(e) that the Secretary could regard a GSE's submission of data, information or report(s) that he or she determines under § 81.102(a), or by “other means” (*i.e.*, pursuant to paragraphs (b), (c) or (d) of § 81.102), are not current, are incomplete, or that otherwise contain an untrue statement of material fact to be equivalent to the GSE's failure to submit such data. As a result of such failure of submission, proposed § 81.102(e) provided that the Department could initiate against the GSE, in accordance with the procedures in 24 CFR part 81, subpart G, an order to cease and desist, an action to seek

civil money penalties, or any other remedies or penalties that may be available to the Secretary as a result of the GSE's failure to provide data submissions, information, and/or report(s) in accordance with § 81.102.

*Summary of Comments.* Several organizations commented, generally, on HUD's proposed requirements in § 81.102 for ensuring the accuracy and integrity of GSE data and other submissions, and almost all expressed support for HUD's proposals relating to data verification. The GSEs commented more specifically on HUD's proposal in § 81.102(e) relating to additional enforcement options.

Fannie Mae asserted that HUD's proposed additional enforcement options were overly broad, and exceeded the Department's authority under FHEFSSA to issue cease and desist orders, impose civil money penalties, and to punish GSE noncompliance by requiring the adoption of a housing plan. Fannie Mae stated that, if HUD decided to retain § 81.102(e), this provision should be redrafted more narrowly.

Freddie Mac, through a legal opinion prepared by outside counsel, asserted that sections 1341 and 1345 of FHEFSSA provide a two-step process before a GSE's failure to submit a housing plan, or its failure to comply with a feasible housing plan, could result in the Department's initiating an action for a cease and desist order or civil money penalties. Freddie Mac asserted that HUD's proposal expanded its enforcement authority beyond the FHEFSSA statutory limits by eliminating this two-step process. Freddie Mac also contended that HUD's enforcement powers under sections 1341 and 1345 of FHEFSSA extend only to instances of intentional non-compliance by the GSE, and that § 81.102 should be narrowed to reflect this limitation.

*HUD's Determination.* The Department has considered the GSEs' and other comments on § 81.102(e) and is making several changes in this final rule in response to these comments. In addition, the Department is making a number of conforming changes to § 81.102(e) to reflect changes that it has also decided to adopt in connection with the other provisions in § 81.102 (primarily in paragraphs (b), (c) and (d)), and is also making minor editorial corrections.

Specifically, the Department is providing in this final rule that:

The Department may pursue additional enforcement remedies under paragraph (e) under either of the following circumstances: (1) When a

GSE fails to submit the certification required by § 81.102(b) in connection with data, information or report(s) required by section 309(m) or (n) of the Fannie Mae Charter Act, section 307(e) or (f) of the Freddie Mac Act, or under 24 CFR part 81, subpart E; or (2) when a GSE submits the certification required by § 81.102(b) in connection with such data, information or report(s), but the Secretary later determines that the data, information or report(s) are not “true, correct and complete” as provided in the certification. The final rule provides that, under either of the above two circumstances, the Secretary may regard a GSE's actions as tantamount to a failure to submit the data, information or report(s) which, in turn, authorizes the Secretary to take the additional enforcement remedies described in § 81.102(e).

The final rule also clarifies that for data, information or report(s) that are subject to § 81.102(c) or (d), the Secretary may only pursue additional enforcement remedies in connection with material errors, omissions or discrepancies. Moreover, if the data, information or report(s) are subject to § 81.102(d), the rule provides that the Secretary may only pursue additional enforcement remedies if the GSE has failed to purchase a sufficient amount or type of mortgages as required by the Secretary under § 81.102(d)(4).

It is the Department's view that § 81.102(e) is needed so that it can take appropriate action to ensure the accuracy and completeness of the GSEs' submissions to HUD, and also to implement the certification that is now established at § 81.102(b) of this final rule, while providing the Secretary with sufficient flexibility to exercise his or her discretion to determine whether enforcement action is appropriate in each instance.

The final rule clarifies that the proposed rule's reference in paragraph (e)(1) to “other means” by which the Secretary may determine that a GSE's data submission(s), information or report(s) fail to meet the prescribed regulatory standards is meant to refer to the Secretary's determinations under paragraphs (b), (c) or (d) of § 81.102 (*i.e.*, the GSE certification in § 81.102(b), the procedure established in § 81.102(c) to verify the accuracy and completeness of the GSE's data for the immediately preceding year, and the procedure established in § 81.102(d) to ensure the accuracy and completeness of the GSE's prior years' data). In the final rule, the Department has deleted the reference to “other means” and has included a specific reference to paragraphs (b), (c) or (d) of § 81.102.

The final rule establishes a bifurcated approach with respect to the types of additional enforcement remedies that the Department may pursue under paragraph (e). This bifurcated approach recognizes that the Department's ability to pursue a cease and desist order, or to levy civil money penalties, applies specifically to data required by section 309(m) or (n) of the Fannie Mae Charter Act or section 307(e) or (f) of the Freddie Mac Act. The rule nevertheless provides that the Department may pursue other types of remedies against a GSE in connection with data that the GSE is required to submit under 24 CFR part 81, subpart E, but that the GSE is not required to submit under section 309(m) or (n) of the Fannie Mae Charter Act or section 307(e) or (f) of the Freddie Mac Charter Act.

The final rule provides that, in connection with either of the two remedial approaches now described in § 81.102(e)(2), the Secretary may pursue any civil or administrative remedies or penalties against the GSE that may be available to the Secretary by virtue of either of the circumstances described in 81.102(e)(1). If the Department elects to pursue a cease-and-desist order or civil money penalties against a GSE under § 81.102(e)(2)(i)(A) or (B), it will comply with the procedures applicable to such actions under 24 CFR part 81, subpart G. Alternatively, if the Department elects to pursue other civil or administrative remedies against a GSE under either §§ 81.102(e)(2)(i)(C) or 81.102(e)(2)(ii), it will pursue such remedies in accordance with applicable law.

Finally, the Department is replacing in paragraph (e) each reference to "HUD" with a reference to "the Secretary." This replacement is designed to ensure that any additional enforcement action that may be pursued under § 81.102(e) will be considered at the highest levels within the Department.

### III. Findings and Certifications

#### *Executive Order 12866*

The Office of Management and Budget (OMB) reviewed this final rule under Executive Order 12866, *Regulatory Planning and Review*, which the President issued on September 30, 1993. This rule was determined to be economically significant under E.O. 12866. Any changes made to this rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276,

Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC. The Economic Analysis prepared for this rule is also available for public inspection in the Office of the Rules Docket Clerk and on HUD's Web site at <http://www.hud.gov>.

#### *Congressional Review of Regulations*

This rule is a "major rule" as defined in Chapter 8 of 5 U.S.C. This rule will be submitted for Congressional review in accordance with this chapter.

#### *Paperwork Reduction Act*

HUD's collection of information on the GSEs' activities has been reviewed and authorized by OMB under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520), as implemented by OMB in regulations at 5 CFR part 1320. The OMB control number is 2502–0514.

#### *Environmental Impact*

This final rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction; or establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. Accordingly, under 24 CFR 50.19(c)(1), this rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

#### *Regulatory Flexibility Act*

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. This rule is applicable only to the GSEs, which are not small entities for purposes of the Regulatory Flexibility Act. Therefore, the rule does not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

#### *Executive Order 13132, Federalism*

Executive Order 13132 ("Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the relevant requirements of section 6 of the executive order are met. This rule does

not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the executive order.

#### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (12 U.S.C. 1531–1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and the private sector. This rule would not impose any federal mandates on any state, local, or tribal government, or on the private sector, within the meaning of UMRA.

#### **List of Subjects in 24 CFR Part 81**

Accounting, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

■ For the reasons discussed in the preamble, HUD is amending 24 CFR part 81 as follows:

#### **PART 81—THE SECRETARY OF HUD'S REGULATION OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE) AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC)**

■ 1. The authority citation for 24 CFR part 81 continues to read as follows:

**Authority:** 12 U.S.C. 1451 *et seq.*, 1716–1723h, and 4501–4641; 28 U.S.C. 2461 note; 42 U.S.C. 3535(d) and 3601–3619.

■ 2. In § 81.2(b), revise the definitions of "Metropolitan area" and "Minority," and paragraph (2) of the definition of "Underserved area," and add a new definition of the term "Home Purchase Mortgage," in alphabetical order, to read as follows:

#### **§ 81.2 Definitions.**

\* \* \* \* \*

(b) \* \* \*

*Home Purchase Mortgage* means a residential mortgage for the purchase of an owner-occupied single-family property.

\* \* \* \* \*

*Metropolitan area* means a metropolitan statistical area ("MSA"), or a portion of such an area for which median family income estimates are published annually by HUD.

*Minority* means any individual who is included within any one or more of the following racial and ethnic categories:

(1) American Indian or Alaskan Native—a person having origins in any of the original peoples of North and South America (including Central

America), and who maintains tribal affiliation or community attachment;

(2) Asian—a person having origins in any of the original peoples of the Far East, Southeast Asia, or the Indian subcontinent, including, for example, Cambodia, China, India, Japan, Korea, Malaysia, Pakistan, the Philippine Islands, Thailand, and Vietnam;

(3) Black or African American—a person having origins in any of the black racial groups of Africa;

(4) Hispanic or Latino—a person of Cuban, Mexican, Puerto Rican, South or Central American, or other Spanish culture or origin, regardless of race; and

(5) Native Hawaiian or Other Pacific Islander—a person having origins in any of the original peoples of Hawaii, Guam, Samoa, or other Pacific Islands.

\* \* \* \* \*

*Underserved area means* \* \* \*

(2) For purposes of the definition of “Rural area,” a whole census tract, a Federal or State American Indian reservation or tribal or individual trust land, or the balance of a census tract excluding the area within any Federal or State American Indian reservation or tribal or individual trust land, having:

(i) A median income at or below 120 percent of the greater of the State non-metropolitan median income or the nationwide non-metropolitan median income and a minority population of 30 percent or greater; or

(ii) A median income at or below 95 percent of the greater of the State non-metropolitan median income or nationwide non-metropolitan median income.

\* \* \* \* \*

■ 3. In § 81.12, revise the last sentence of paragraph (b) and revise paragraph (c), to read as follows:

**§ 81.12 Low- and Moderate-Income Housing Goal.**

\* \* \* \* \*

(b) *Factors.* \* \* \* A statement documenting HUD’s considerations and findings with respect to these factors, entitled “Departmental Considerations to Establish the Low- and Moderate-Income Housing Goal,” was published in the **Federal Register** on November 2, 2004.

(c) *Goals.* The annual goals for each GSE’s purchases of mortgages on housing for low- and moderate-income families are:

(1) For the year 2005, 52 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Low- and Moderate-Income Housing Home Purchase

Subgoal, 45 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Low- and Moderate-Income Housing Goal in the year 2005 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(2) For the year 2006, 53 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Low- and Moderate-Income Housing Home Purchase Subgoal, 46 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Low- and Moderate-Income Housing Goal in the year 2006 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(3) For the year 2007, 55 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Low- and Moderate-Income Housing Home Purchase Subgoal, 47 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Low- and Moderate-Income Housing Goal in the year 2007 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(4) For the year 2008, 56 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Low- and Moderate-Income Housing Home Purchase Subgoal, 47 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Low- and Moderate-Income Housing Goal in the year 2008 unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(5) For the year 2009 and thereafter HUD shall establish annual goals. Pending establishment of goals for the year 2009 and thereafter, the annual goal for each of those years shall be 56 percent of the total number of dwelling units financed by that GSE’s mortgage purchases in each of those years. In addition, as a Low and Moderate Income Housing Home Purchase Subgoal, 47 percent of the total number of home purchase mortgages in

metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Low- and Moderate-Income Housing Goal in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA.

■ 4. In § 81.13, revise the last sentence of paragraph (b) and revise paragraph (c), to read as follows:

**§ 81.13 Central Cities, Rural Areas, and Other Underserved Areas Housing Goal.**

\* \* \* \* \*

(b) *Factors.* \* \* \* A statement documenting HUD’s considerations and findings with respect to these factors, entitled “Departmental Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal,” was published in the **Federal Register** on November 2, 2004.

(c) *Goals.* The annual goals for each GSE’s purchases of mortgages on housing located in central cities, rural areas, and other underserved areas are:

(1) For the year 2005, 37 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Central Cities, Rural Areas, and Other Underserved Areas Home Purchase Subgoal, 32 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal in the year 2005 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(2) For the year 2006, 38 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Central Cities, Rural Areas, and Other Underserved Areas Home Purchase Subgoal, 33 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE’s mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal in the year 2006 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(3) For the year 2007, 38 percent of the total number of dwelling units financed by that GSE’s mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Central Cities, Rural Areas, and Other Underserved Areas

Home Purchase Subgoal, 33 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal in the year 2007 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(4) For the year 2008, 39 percent of the total number of dwelling units financed by that GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Central Cities, Rural Areas, and Other Underserved Areas Home Purchase Subgoal, 34 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal in the year 2008 unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(5) For the year 2009 and thereafter HUD shall establish annual goals. Pending establishment of goals for the year 2009 and thereafter, the annual goal for each of those years shall be 39 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years. In addition, as a Central Cities, Rural Areas, and Other Underserved Areas Home Purchase Subgoal, 34 percent of the total number of home purchase mortgages in metropolitan areas financed by that GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA.

\* \* \* \* \*

■ 5. In § 81.14, revise the last sentence of paragraph (b) and revise paragraph (c), to read as follows:

**§ 81.14 Special Affordable Housing Goal.**

\* \* \* \* \*

(b) \* \* \* A statement documenting HUD's considerations and findings with respect to these factors, entitled "Departmental Considerations to Establish the Special Affordable Housing Goal," was published in the **Federal Register** on November 2, 2004.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on rental and owner-occupied housing meeting the then-existing, unaddressed needs of

and affordable to low-income families in low-income areas and very low-income families are:

(1) For the year 2005, 22 percent of the total number of dwelling units financed by each GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal for the year 2005 shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the average annual dollar volume of combined (single-family and multifamily) mortgages purchased by the respective GSE in 2000, 2001, and 2002, unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Special Affordable Housing Home Purchase Subgoal, 17 percent of the total number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Special Affordable Housing Goal in the year 2005 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(2) For the year 2006, 23 percent of the total number of dwelling units financed by each GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal for the year 2006 shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the average annual dollar volume of combined (single-family and multifamily) mortgages purchased by the respective GSE in 2000, 2001, and 2002, unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Special Affordable Housing Home Purchase Subgoal, 17 percent of the total number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Special Affordable Housing Goal in the year 2006 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(3) For the year 2007, 25 percent of the total number of dwelling units financed by each GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal for the year 2007 shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the average annual dollar volume of combined (single-family and multifamily) mortgages purchased by the respective GSE in 2000, 2001, and 2002, unless otherwise adjusted by HUD in

accordance with FHEFSSA. In addition, as a Special Affordable Housing Home Purchase Subgoal, 18 percent of the total number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Special Affordable Housing Goal in the year 2007 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(4) For the year 2008, 27 percent of the total number of dwelling units financed by each GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal for the year 2008 shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the average annual dollar volume of combined (single-family and multifamily) mortgages purchased by the respective GSE in 2000, 2001, and 2002, unless otherwise adjusted by HUD in accordance with FHEFSSA. In addition, as a Special Affordable Housing Home Purchase Subgoal, 18 percent of the total number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Special Affordable Housing Goal in the year 2008 unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(5) For the year 2009 and thereafter HUD shall establish annual goals. Pending establishment of goals for the year 2009 and thereafter, the annual goal for each of those years shall be 27 percent of the total number of dwelling units financed by each GSE's mortgage purchases in each of those years. The goal for each such year shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the annual average dollar volume of combined (single-family and multifamily) mortgages purchased by the respective GSE in the years 2000, 2001, and 2002. In addition, as a Special Affordable Housing Home Purchase Subgoal, 18 percent of the total number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases shall be home purchase mortgages in metropolitan areas which count toward the Special Affordable Housing Goal in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA.

\* \* \* \* \*

■ 6. In § 81.15, revise paragraphs (d), (e)(6)(i), and (e)(6)(ii) and add a new paragraph (i), to read as follows:

**§ 81.15 General requirements.**

\* \* \* \* \*

(d) *Counting owner-occupied units.*

(1) For purposes of counting owner-occupied units toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, mortgage purchases financing such units shall be evaluated based on the income of the mortgagors and the area median income at the time of origination of the mortgage. To determine whether mortgages may be counted under a particular family income level, i.e., especially low, very low, low or moderate income, the income of the mortgagors is compared to the median income for the area at the time of the mortgage application, using the appropriate percentage factor provided under § 81.17.

(2)(i) When the income of the mortgagor(s) is not available to determine whether an owner-occupied unit in a property securing a single-family mortgage originated after 1992 and purchased by a GSE counts toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, a GSE's performance with respect to such unit may be evaluated using estimated affordability information in accordance with one of the following methods:

(A) Excluding from the denominator and the numerator single-family owner-occupied units located in census tracts with median incomes less than, or equal to, area median income based on the most recent decennial census, up to a maximum of one percent of the total number of single-family owner-occupied dwelling units eligible to be counted toward the respective housing goal in the current year. Mortgage purchases with missing data in excess of the maximum will be included in the denominator and excluded from the numerator;

(B) For home purchase mortgages and for refinance mortgages separately, multiplying the number of owner-occupied units with missing borrower income information in properties securing mortgages purchased by the GSE in each census tract by the percentage of all single-family owner-occupied mortgage originations in the respective tracts that would count toward achievement of each goal, as determined by HUD based on the most recent HMDA data available; or

(C) Such other data source and methodology as may be approved by HUD.

(ii) In any calendar year, a GSE may use only one of the methods specified in paragraph (d)(2)(i) of this section to estimate affordability information for single-family owner-occupied units.

(iii) If a GSE chooses to use an estimation methodology under paragraph (d)(2)(i)(B) or (d)(2)(i)(C) of this section to determine affordability for owner-occupied units in properties securing single-family mortgage purchases eligible to be counted toward the respective housing goal, then that methodology may be used up to nationwide maximums for home purchase mortgages and for refinance mortgages that shall be calculated by multiplying, for each census tract, the percentage of all single-family owner-occupied mortgage originations with missing borrower incomes (as determined by HUD based on the most recent HMDA data available for home purchase and refinance mortgages, respectively) by the number of single-family owner-occupied units in properties securing mortgages purchased by the GSE for each census tract, summed up over all census tracts. If this nationwide maximum is exceeded, then the estimated number of goal-qualifying units will be adjusted by the ratio of the applicable nationwide maximum number of units for which income information may be estimated to the total number of single-family owner-occupied units with missing income information in properties securing mortgages purchased by the GSE. Owner-occupied units in excess of the nationwide maximum, and any units for which estimation information is not available, shall remain in the denominator of the respective goal calculation.

(e) \* \* \*

(6) \* \* \*

(i) *Multifamily.* (A) When a GSE lacks sufficient information to determine whether a rental unit in a property securing a multifamily mortgage purchased by a GSE counts toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal because neither the income of prospective or actual tenants, nor the actual or average rental data, are available, a GSE's performance with respect to such unit may be evaluated using estimated affordability information in accordance with one of the following methods:

(1) Multiplying the number of rental units with missing affordability information in properties securing multifamily mortgages purchased by the GSE in each census tract by the percentage of all rental dwelling units in the respective tracts that would count

toward achievement of each goal, as determined by HUD based on the most recent decennial census. For units with missing affordability information in tracts for which such methodology is not possible, such units will be excluded from the denominator as well as the numerator in calculating performance under the respective housing goal(s); or

(2) Such other data source and methodology as may be approved by HUD.

(B) In any calendar year, a GSE may use only one of the methods specified in paragraph (e)(6)(i)(A) of this section to estimate affordability information for multifamily rental units.

(C) If a GSE chooses to use an estimation methodology under paragraph (e)(6)(i)(A) of this section to determine affordability for rental units in properties securing multifamily mortgage purchases eligible to be counted toward the respective housing goal, then that methodology may be used up to a nationwide maximum of ten percent of the total number of rental units in properties securing multifamily mortgages purchased by the GSE in the current year. If this maximum is exceeded, the estimated number of goal-qualifying units will be adjusted by the ratio of the nationwide maximum number of units for which affordability information may be estimated to the total number of multifamily rental units with missing affordability information in properties securing mortgages purchased by the GSE. Multifamily rental units in excess of the maximum set forth in this paragraph (e)(6)(i)(C), and any units for which estimation information is not available, shall be removed from the denominator of the respective goal calculation.

(ii) *Rental units in 1-4 unit single-family properties.* (A) When a GSE lacks sufficient information to determine whether a rental unit in a property securing a single-family mortgage purchased by a GSE counts toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal because neither the income of prospective or actual tenants, nor the actual or average rental data, are available, a GSE's performance with respect to such unit may be evaluated using estimated affordability information in accordance with one of the following methods:

(1) Excluding rental units in 1-to 4-unit properties with missing affordability information from the denominator as well as the numerator in calculating performance under those goals;

(2) Multiplying the number of rental units with missing affordability information in properties securing single family mortgages purchased by the GSE in each census tract by the percentage of all rental dwelling units in the respective tracts that would count toward achievement of each goal, as determined by HUD based on the most recent decennial census. For units with missing affordability information in tracts for which such methodology is not possible, such units will be excluded from the denominator as well as the numerator in calculating performance under the respective housing goal(s); or

(3) Such other data source and methodology as may be approved by HUD.

(B) In any calendar year, a GSE may use only one of the methods specified in paragraph (e)(6)(ii)(A) of this section to estimate affordability information for single-family rental units.

(C) If a GSE chooses to use an estimation methodology under paragraph (e)(6)(ii)(A)(2) or (e)(6)(ii)(A)(3) of this section to determine affordability for rental units in properties securing single-family mortgage purchases eligible to be counted toward the respective housing goal, then that methodology may be used up to nationwide maximums of five percent of the total number of rental units in properties securing non-seasoned single-family mortgage purchases by the GSE in the current year and 20 percent of the total number of rental units in properties securing seasoned single-family mortgage purchases by the GSE in the current year. If either or both of these maximums are exceeded, the estimated number of goal-qualifying units will be adjusted by the ratio of the applicable nationwide maximum number of units for which affordability information may be estimated to the total number of single-family rental units with missing affordability information in properties securing seasoned or unseasoned mortgages purchased by the GSE, as applicable. Single-family rental units in excess of the maximums set forth in this paragraph (e)(6)(ii)(C), and any units for which estimation information is not available, shall be removed from the denominator of the respective goal calculation.

\* \* \* \* \*

(i) *Counting mortgages toward the Home Purchase Subgoals.* (1) *General.* The requirements of this section, except for paragraphs (b) and (e) of this section, shall apply to counting mortgages toward the Home Purchase Subgoals at

§§ 81.12 through 81.14. However, performance under the subgoals shall be counted using a fraction that is converted into a percentage for each subgoal and the numerator of the fraction for each subgoal shall be the number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases in a particular year that count towards achievement of the applicable housing goal. The denominator of each fraction shall be the total number of home purchase mortgages in metropolitan areas financed by each GSE's mortgage purchases in a particular year. For purposes of each subgoal, the procedure for addressing missing data or information, as set forth in paragraph (d) of this section, shall be implemented using numbers of home purchase mortgages in metropolitan areas and not single-family owner-occupied dwelling units.

(2) *Special counting rule for mortgages with more than one owner-occupied unit.* For purposes of counting mortgages toward the Home Purchase Subgoals, where a single home purchase mortgage finances the purchase of two or more owner-occupied units in a metropolitan area, the mortgage shall count once toward each subgoal that applies to the GSE's mortgage purchase.

■ 7. In § 81.16, revise paragraphs (c)(6) and (c)(7), remove and reserve paragraphs (c)(10) and (c)(11), and add a paragraph (c)(14), to read as follows:

**§ 81.16 Special counting requirements.**

\* \* \* \* \*

(c) \* \* \*

(6) *Seasoned mortgages.* A GSE's purchase of a seasoned mortgage shall be treated as a mortgage purchase for purposes of these goals and shall be included in the numerator, as appropriate, and the denominator in calculating the GSE's performance under the housing goals, except where:

(i) The GSE has already counted the mortgage under a housing goal applicable to 1993 or any subsequent year; or

(ii) HUD determines, based upon a written request by a GSE, that a seasoned mortgage or class of such mortgages should be excluded from the numerator and the denominator in order to further the purposes of the Special Affordable Housing Goal.

(7) *Purchase of refinanced mortgages.* Except as otherwise provided in this part, the purchase of a refinanced mortgage by a GSE is a mortgage purchase and shall count toward achievement of the housing goals to the extent the mortgage qualifies.

\* \* \* \* \*

(14) *Seller dissolution option.* (i) Mortgages acquired through transactions involving seller dissolution options shall be treated as mortgage purchases, and receive credit toward the achievement of the housing goals, only when:

(A) The terms of the transaction provide for a lockout period that prohibits the exercise of the dissolution option for at least one year from the date on which the transaction was entered into by the GSE and the seller of the mortgages; and

(B) The transaction is not dissolved during the one-year minimum lockout period.

(ii) The Secretary may grant an exception to the one-year minimum lockout period described in paragraph (c)(14)(i)(A) and (B) of this section, in response to a written request from an enterprise, if the Secretary determines that the transaction furthers the purposes of FHEFSSA and the GSE's charter act;

(iii) For purposes of this paragraph (c)(14), "seller dissolution option" means an option for a seller of mortgages to the GSEs to dissolve or otherwise cancel a mortgage purchase agreement or loan sale.

\* \* \* \* \*

■ 8. Revise § 81.102 to read as follows:

**§ 81.102 Verification and enforcement to ensure GSE data integrity.**

(a) *Independent verification authority.* The Secretary may independently verify the accuracy and completeness of the data, information, and reports provided by each GSE, including conducting on-site verification, when such steps are reasonably related to determining whether a GSE is complying with 12 U.S.C. 4541–4589 and the GSE's Charter Act.

(b) *Certification.* (1) The senior officer of each GSE who is responsible for submitting to HUD the fourth quarter Annual Mortgage Report and the AHAR under sections 309(m) and (n) of the Fannie Mae Charter Act or sections 307(e) and (f) of the Freddie Mac Act, as applicable, or for submitting to the Secretary such other report(s), data, or information for which certification is requested in writing by the Secretary, shall certify such report(s), data or information.

(2) The certification shall state as follows: "To the best of my knowledge and belief, the information provided herein is true, correct and complete."

(3) If the Secretary determines that a GSE has failed to provide the certification required by paragraphs (b)(1) and (b)(2) of this section, or that a GSE has provided the certification

required by paragraph (b) in connection with data, information or report(s) that the Secretary later determines are not true, correct and complete, the Secretary may pursue the enforcement remedies under paragraph (e) of this section. For data, information or report(s) subject to paragraphs (c) or (d) of this section, the Secretary may pursue the enforcement remedies described in paragraph (e) only in connection with material errors, omissions or discrepancies as those terms are defined in § 81.102(c) or (d).

(c) *Verification procedure and adjustment to correct errors, omissions or discrepancies in AHAR data for the immediately preceding year.* (1) This paragraph (c) pertains to the GSEs' submission of year-end data. For purposes of this paragraph, "year-end data" means data that HUD receives from the GSEs related to housing goals performance in the immediately preceding year and covering data reported in the fourth quarter Annual Mortgage Report and the GSE's AHAR. An "error" means a technical mistake, such as a mistake in coding or calculating data. An "omission" means a GSE's failure to count units in the denominator. A "discrepancy" means any difference between HUD's analysis of data and the analysis contained in a GSE's submission of data, including a discrepancy in goal or Special Affordable subgoal performance.

(2) If HUD finds errors, omissions or discrepancies in a GSE's year-end data submissions relative to HUD's regulations, HUD will first notify the GSE by telephone or e-mail transmission of each such error, omission or discrepancy. The GSE must respond within five working days of each such notification. HUD may, in its discretion or upon a request by a GSE within the five working day period, extend the response period for up to an additional 20 working days. Information exchanges during the five working day period following initial notification, and any subsequent extensions of time that may be granted, may be by electronic mail. Any person with delegated authority from the Secretary, or the Director of HUD's Financial Institution Regulation Division, or his or her designee, shall be responsible for issuing initial notifications regarding errors, omissions, or discrepancies; making determinations on the adequacy of responses received; approving any extensions of time permitted under this provision; and managing the data verification process.

(3) If each error, omission or discrepancy is not resolved to HUD's satisfaction during the initial five working day period from notification,

and any extension period, the Secretary will notify the GSE in writing and seek clarification or additional information to correct the error, omission or discrepancy. The GSE shall have 10 working days (or such longer period as the Secretary may establish, not to exceed 30 working days) from the date of the Secretary's written notice to respond in writing to the notice. If the GSE fails to submit a written response to the Secretary within this period, or if the Secretary determines that the GSE's written response fails to correct or otherwise resolve each error, omission or discrepancy in its reported year-end data to the Secretary's satisfaction, the Secretary will determine the appropriate adjustments to the numerator and the denominator of the applicable housing goal(s) and Special Affordable subgoal(s) due to the GSE's failure to provide the Secretary with accurate submissions of data.

(4) The Secretary, or his or her designee, shall inform a GSE in writing, at least five working days prior to HUD's release of its official performance figures to the public, of HUD's determination of official goals performance figures, including any adjustments. During the five working days prior to such public release, a GSE may request, in writing, a reconsideration of HUD's final determination of its performance and must provide the basis for requesting the reconsideration. If the request is granted, the Secretary will consider the GSE's request for reconsideration of its determination of goals performance and make a final determination regarding the GSE's performance, within 10 working days of the Secretary's granting of the GSE's written request for reconsideration.

(5) Should the Secretary determine that additional enforcement action against the GSE is warranted for material errors, omissions or discrepancies with regard to a housing goal or Special Affordable subgoal, it may pursue additional remedies under paragraph (e) of this section. An error, omission or discrepancy is material if it results in an overstatement of credit for a housing goal or Special Affordable subgoal, and, without such overstatement, the GSE would have failed to meet such housing goal or Special Affordable subgoal for the immediately preceding year.

(d) *Adjustment to correct prior year reporting errors, omissions or discrepancies.* (1) *General.* The Secretary may require a GSE to correct a material error, omission or discrepancy in a GSE's prior year's data reported in the fourth quarter Annual Mortgage Report and the GSE's AHAR

under sections 309(m) and (n) of the Fannie Mae Charter Act or sections 307(e) and (f) of the Freddie Mac Act, as applicable. An error, omission or discrepancy is material if it results in an overstatement of credit for a housing goal or Special Affordable subgoal and, without such overstatement, the GSE would have failed to meet such housing goal or Special Affordable subgoal for the prior year. A "prior year" for purposes of this section is any one of the two years immediately preceding the latest year for which data on housing goals performance was reported to HUD.

(2) *Procedural requirements.* In the event the Secretary determines that a GSE's prior year's fourth quarter Annual Mortgage Report or AHAR contain a material error, omission or discrepancy, the Secretary will provide the GSE with an initial letter containing written findings and determinations within 24 months of the end of the relevant GSE reporting year. The GSE shall have an opportunity, not to exceed 30 days from the date of receipt of the Secretary's initial letter, to respond in writing with supporting documentation, to contest the Secretary's initial determination that there was a material error, omission or discrepancy in a prior year's data. The Secretary shall then issue a final determination letter within 60 days of the date of HUD's receipt of the GSE's written response or, if no response is received, within 90 days of the date of the GSE's receipt of the Secretary's initial letter. The Secretary may extend the period for issuing a final determination letter by an additional 30 days and may grant the GSE an opportunity, for a period not to exceed 10 working days from the date of the GSE's receipt of the determination letter to request that the determination be reconsidered.

(3) If the Secretary determines that a GSE's prior year's fourth quarter Annual Mortgage Report or AHAR contained a material error, omission or discrepancy, the Secretary may direct the GSE to correct the overstatement by purchasing mortgages to finance the number of units that HUD has determined were overstated in the prior year's goal performance (or, for the Special Affordable subgoal, the number or dollar amount, as applicable, of mortgage purchases that HUD has determined were overstated), or that equal the percentage of the overstatement in the prior year's goal or Special Affordable subgoal performance as applied to the most current year-end performance, whichever is less. Units or mortgages purchased to remedy an overstatement in the housing goals or

the Special Affordable subgoal must be eligible to qualify under the same goal or Special Affordable subgoal that HUD has determined were overstated in the prior year.

(4) If a GSE does not purchase a sufficient amount or type of mortgages to meet the requirements set forth in paragraph (d)(3) of this section as directed by the Secretary by no later than the end of the calendar year immediately following the year in which the Secretary notifies the GSE of such overstatement (unless, upon written request from the GSE, the Secretary, in his or her discretion, determines that a grant of additional time is appropriate to correct or compensate for the overstatement) the Department may pursue any or all of the following remedies:

(i) Issue a notice that the GSE has failed a housing goal or Special Affordable subgoal in the prior year;

(ii) Seek additional enforcement remedies under paragraph (e) of this section;

(iii) Pursue any other civil or administrative remedies as are available to it.

(e) *Additional enforcement options.*

(1) *General.* In the event the Secretary determines, either as a result of his or her independent verification authority described in paragraph (a) of this section, or by the authority set forth in paragraphs (b), (c) or (d) of this section, that any of the following circumstances has occurred with respect to data, information or report(s) required by sections 309(m) or (n) of the Fannie Mae Charter Act, sections 307(e) or (f) of the Freddie Mac Act, or subpart E of this part, the Secretary may regard this as a GSE's failure to submit such data, information or report(s) and, accordingly, the Secretary may take the additional enforcement actions authorized by paragraph (e)(2) of this section:

(i) A GSE fails to submit the certification required by paragraphs (b)(1) and (b)(2) of this section in connection with such data, information or report(s); or

(ii) A GSE submits the certification required by paragraph (b) of this section, but the Secretary later determines that the data, information or report(s) are not true, correct and complete. For data, information or report(s) subject to paragraphs (c) or (d) of this section, the Secretary may pursue the additional enforcement remedies under paragraph (e)(2) only in connection with material errors, omissions or discrepancies, as those terms are defined in § 81.102(c) or (d). In addition, the Secretary may only pursue such remedies in connection

with material errors, omissions or discrepancies arising under paragraph (d) of this section if the GSE has failed to purchase a sufficient amount or type of mortgages, as provided in paragraphs (d)(3) and (d)(4) of this section.

(2) *Remedies.* (i) *Submissions required under the GSE's charter acts.* After the Secretary makes a determination under paragraph (e)(1) of this section that any of the circumstances described in paragraphs (e)(1)(i) or (ii) has occurred with respect to data, information, or report(s) required by sections 309(m) or (n) of the Fannie Mae Charter Act, or by sections 307(e) or (f) of the Freddie Mac Act, the Secretary may pursue any or all of the following remedies in accordance with paragraph (e)(3), or applicable law, as appropriate:

(A) A cease-and-desist order against the GSE for failing to submit the required data, information or report(s) in accordance with this section;

(B) Civil money penalties against the GSE for failing to submit the required data, information or report(s) in accordance with this section;

(C) Any other civil or administrative remedies or penalties against the GSE that may be available to the Secretary by virtue of the GSE's failing to submit or certify the required data, information or report(s) in accordance with this section.

(ii) *Submissions required under subpart E of this part.* After the Secretary makes a determination under paragraph (e)(1) of this section that any of the circumstances described in paragraphs (e)(1)(i) or (ii) has occurred with respect to data, information or report(s) required under subpart E of this part (but that are not required by sections 309(m) or (n) of the Fannie Mae Charter Act or by sections 307(e) or (f) of the Freddie Mac Act), the Secretary may pursue any civil or administrative remedies or penalties against the GSE that may be available to the Secretary. The Secretary shall pursue such remedies under applicable law.

(3) *Procedures.* The Secretary shall comply with the procedures set forth in subpart G of this part in connection with any enforcement action that he or she may initiate against a GSE under paragraph (e) of this section.

Dated: October 22, 2004.

**John C. Weicher,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

**Note:** The Appendices will not appear in the Code of Federal Regulations.

## Appendix A

### Departmental Considerations To Establish The Low- and Moderate-Income Housing Goal

#### A. Introduction

Sections 1 and 2 provide a basic description of the rule process. Section 3 discusses HUD's conclusions based on consideration of the factors.

#### 1. Establishment of Low- and Moderate-Income Housing Goal

In establishing the Low- and Moderate-Income Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), collectively referred to as the Government-Sponsored Enterprises (GSEs), section 1332 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4562) (FHEFSSA) requires the Secretary to consider:

1. National housing needs;
  2. Economic, housing, and demographic conditions;
  3. The performance and effort of the enterprises toward achieving the Low- and Moderate-Income Housing Goal in previous years;
  4. The size of the conventional mortgage market serving low- and moderate-income families relative to the size of the overall conventional mortgage market;
  5. The ability of the enterprises to lead the industry in making mortgage credit available for low- and moderate-income families; and
  6. The need to maintain the sound financial condition of the enterprises.
- The Secretary also considered these factors in establishing a low- and moderate-income subgoal for home purchase loans on single-family-owner properties in metropolitan areas.

#### 2. Underlying Data

In considering the statutory factors in establishing these goals, HUD relied on data from the 2001 American Housing Survey, the 2000 Censuses of Population and Housing, the 2001 Residential Finance Survey (RFS), the 1995 Property Owners and Managers Survey (POMS), other government reports, reports submitted in accordance with the Home Mortgage Disclosure Act (HMDA), and the GSEs. In order to measure performance toward achieving the Low- and Moderate-Income Housing Goal in previous years, HUD analyzed the loan-level data on all mortgages purchased by the GSEs for 1993–2003 in accordance with the goal counting provisions established by the Department in the December 1995 and October 2000 rules (24 CFR part 81).

#### 3. Conclusions Based on Consideration of the Factors

The discussion of the first two factors covers a range of topics on housing needs and economic and demographic trends that are important for understanding mortgage markets. Information is provided which describes the market environment in which the GSEs must operate (for example, trends in refinancing activity). In addition, the severe housing problems faced by lower-